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BUSINESS LAW SECTION

REPORT ON THIRD-PARTY REMEDIES OPINIONS

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REPORT ON THIRD-PARTY REMEDIES OPINIONS

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REPORT ON THIRD-PARTY REMEDIES OPINIONS

I. EXECUTIVE SUMMARY

Too much time, effort and money are expended on third-party legal opinions. The main contributor to this excess is the remedies opinion, i.e., the opinion provided at the close of a business transaction by one party's counsel to another party that a contract in the transaction is valid, binding and enforceable against the opinion giver's client.

The remedies opinion, like third-party legal opinions generally, can serve as an important part of the opinion recipient's "diligence" about the transaction. There can be, however, significant time, financial costs and other burdens placed on the transaction by the inclusion of a remedies opinion. In many transactions, that burden is justified. In many others, it is not.

The purpose of this report is to make the opinion process more efficient and to reduce significantly the burden on lawyers and their clients related to remedies opinions, by addressing several key matters:

1. As a threshold matter, what factors should be considered in determining whether to request or give a remedies opinion in a particular transaction? A remedies opinion should not routinely be requested without careful thought, just because it shows up on someone's checklist. It is too expensive (in time, effort and money) for that. This report (Section III below) provides a cost-benefit framework for determining the appropriateness of requesting a remedies opinion in a transaction.
2. This report explains the concept of "customary practice" (Section IV below) and shows how that concept can be used to ease the risk and burden of giving remedies opinions (Section V below).
3. By using the concept of customary practice, this report (Section V below) concludes that the long-standing supposed continental divide over the meaning and scope of the remedies opinion - the "New York view" that it covers "each and every" provision of a contract versus the "California view" that it covers only the "essential provisions" - should no longer be of concern in opinion practice. Instead, the focus should be on customary practice. Customary practice is comprised of customary diligence (particularly the legal diligence customarily undertaken in giving a remedies opinion), customary competence, and customary usage (the customarily understood meaning of terms used in third-party legal opinions).
4. Whatever other support there may have been for the difference between the "California view" and the "New York view," this report (Section VI below) concludes that it is not supported by any meaningful difference between the laws of California and New York.
5. This report (Section VII below) provides a framework for analyzing the "laundry list" of exceptions often included in opinion letters with remedies opinions. This framework is based on analysis of California law applicable to common contractual provisions. It divides these provisions into several categories and analyzes whether separately stated exceptions to the

remedies opinion are required when these provisions are present in a contract.

6. This report (Section VIII below) provides an approach to using the “generic exception” in non-real estate transactions.

The Business Law Section urges all lawyers involved in giving or receiving remedies opinions to use this report to make the opinion process a more effective communications tool and to reduce the opinion-related burdens on themselves and their clients.

II. INTRODUCTION; HOW TO USE THIS REPORT

This report of the Business Law Section of the State Bar of California summarizes the work of its Opinions Committee¹ (the members of which are set forth in Appendix 2) on remedies opinions² in third-party opinion letters. It updates portions of the Section’s 1989 Report, providing guidance to California lawyers about practices regarding remedies opinions. It is also intended to contribute to the process of achieving national uniformity in the preparation and interpretation of remedies opinions.

The Section has for many years published reports to provide guidance to California opinion givers and California lawyers representing opinion recipients. The first was a comprehensive report on opinion letters published by the Corporations Committee of the Section in 1982; that report was revised and updated in 1989.³ The 1989 Report addressed, among other things, the remedies opinion. In a different context, that discussion was supplemented by the Section’s 1992 Report, which was issued in response to the ABA’s Accord.

Drafts of this report were circulated broadly to relevant Committees of the Section and other practitioners in California and elsewhere for comment, and this report was approved by the Section Executive Committee for publication as a report of the Section. Although the Section does not take responsibility for the accuracy of this report at any particular time after its issuance, it is intended to be a “living document,” to be updated from time to time as required to reflect changed circumstances and views. These updates will be available on the Opinions Committee’s Website at www.calbar.ca.gov/buslaw/opinions.

¹ The Opinions Committee expresses its appreciation to James Burnett and Kimberly Taylor of Morrison & Foerster LLP for their editorial assistance in preparing this report.

² A glossary of terms used in this report is attached *infra* as App. 1.

³ Other Section reports are listed in Business Law Section of the State Bar of California, *Statement of the Business Law Section of the State Bar of California* (2001) [hereinafter *2001 Statement*], attached *infra* as App. 3. Reports on legal opinions by the Section, and by a joint committee of the California Real Property Law Section and the Real Property Section of the Los Angeles County Bar Association, were compiled and published by the California Business Law and Real Property Law Sections in the *2002 California Opinion Reports* [hereinafter *2002 Compendium*]. The *2002 Compendium* may be obtained from the Business Law Section at www.calbar.org/buslaw/publications, then click on “2002 California Opinions Compendium.” Other valuable resources published outside of California are briefly commented upon in the *2001 Statement*. California practitioners will find all these reports and resources useful in their opinion practices.

To order additional copies of this report and its appendices, contact the Business Law Section at www.calbar.org/buslaw/publications, then click on “2004 Remedies Opinion Report.”

A. What is a Remedies Opinion?

A remedies opinion is usually part of a more comprehensive third-party closing opinion delivered in a business transaction, as part of the opinion recipient’s “due diligence” about the transaction. A remedies opinion is intended to provide assurances to its recipient concerning the enforceability of the contracts signed and delivered by the parties at closing. It addresses whether and subject to what limitations a contract is valid, binding and enforceable against the opinion giver’s client.⁴ By customary usage,⁵ it means that (i) a contract has been formed, (ii) a remedy will be available in the event of a breach of the undertakings in the contract (or the undertakings will otherwise be given effect⁶), and (iii) remedies in the contract will be given effect,⁷ unless, in the case of (ii) or (iii), expressly or implicitly excluded. The wording of the opinion varies somewhat, but its meaning is not dependent on the exact words used,⁸ although some believe it should at minimum contain the word “binding” or “enforceable.”⁹

The remedies opinion is different from other related opinions often found in third-party opinion letters -- for example, existence of the opinion giver’s client; its due authorization, execution and delivery of the contract; no violation of laws; and attachment or perfection of a security interest in personal property. These opinions sometimes relate to issues similar to, and some are predicates for, the remedies opinion. They should not be confused with the remedies opinion. If the contract has not been duly authorized, executed or delivered, the contract may not have been formed. If the contract violates a law that renders it invalid, it may not be enforceable.

⁴ See Corp. Comm. of the Bus. Law Section of the State Bar of Cal., *1989 Report of the Committee on Corporations of the Business Law Section of the State Bar of California Regarding Legal Opinions in Business Transactions*, 45 Bus. Law. 2169 (1990) [hereinafter *1989 Report*], § V.C; Bus. Law Section of the State Bar of Cal., *Report on the Third-Party Legal Opinion Report of the ABA Section of Business Law* (1992) [hereinafter *1992 Report*], § III.A; The TriBar Opinion Committee, *Third-Party “Closing” Opinions*, 53 Bus. Law. 591 (1998) [hereinafter *1998 TriBar Report*], § 3.1; Am. Bar Ass’n. Comm. on Legal Opinions, *Third-Party Legal Opinion Report, Including the Legal Opinion Accord of the Section of Business Law, American Bar Association*, 47 Bus. Law. 167 (1991) [hereinafter *Accord Report*], ¶ 10.3. As of September 2004, the Corporations Committee of the Section is close to finalizing a report that revises and restates the *1989 Report*. The new report, however, will not address remedies opinions except by reference to this Report and its appendices, which collectively supersede the relevant portions of the *1989 Report*.

⁵ See *infra* App. 5.

⁶ See *infra* § V for a discussion of a historic debate over whether the remedies opinion covers “each and every” provision of the contract, or only the “essential provisions.” See also *1989 Report* § V.C; *Accord Report* § 10; *1998 TriBar Report* § 3.1 & n. 69.

⁷ Meaning (iii) was not expressly set forth in the *1989 Report*.

⁸ *1989 Report* § V.C; *Accord Report* ¶ 10.1; *1998 TriBar Report* § 3.1. Typically, the remedies opinion reads as follows: “The Agreement is a valid and binding obligation of the Company enforceable against the Company in accordance with its terms.”

⁹ *1998 TriBar Report* § 3.1.

In order for a security interest in collateral to be perfected, among other things it must attach to the collateral; and, in order to attach to the collateral, among other things it must be enforceable against the debtor with respect to the collateral.

B. Reasons for this Report

In updating a portion of the 1989 Report, this report responds to long-standing frustration of lawyers and their clients, inside and outside California, over the time, energy and money spent in negotiating the remedies opinion. The timing of this report is dictated by the publication in recent years of excellent reports and literature in other jurisdictions discussing the remedies opinion, giving rise to the need to provide further guidance to California lawyers on this topic.¹⁰

Heavy Negotiation. Remedies opinions are often heavily negotiated, resulting in increased transactional costs and generating tensions and lost time in accomplishing the related transactions. Controversial issues include the necessity and importance of “laundry lists” of separately stated exceptions¹¹ and the use of a generic exception,¹² arising in part out of disagreement over the meaning and scope of the remedies opinion.

The Meaning and Scope of the Remedies Opinion. Two different leading views of the meaning and scope of the remedies opinion have been viewed historically as having a geographic base. The New York-based TriBar Opinion Committee is the primary advocate for the “New York view” that the remedies opinion covers “each and every” undertaking in the subject contract. The California Business Law Section has led the advocacy of the “California view” that the remedies opinion covers only the “essential provisions” of the contract. In light of this supposed geographic dichotomy, resolution of this issue has become progressively more important as more businesses and business transactions have become national in scope, and as more law firms have established offices in multiple jurisdictions. This report concludes that the dichotomy is no longer relevant to opinion practice, and the dispute should be discontinued. Instead, opinion givers, opinion recipients and their counsel should focus on the competence and legal diligence customarily exercised by lawyers in the preparation and rendering of remedies opinions.¹³

While this report does not discuss every issue relating to the remedies opinion,¹⁴ it is designed to help reduce the foregoing tensions.

¹⁰ See *infra* App. 3.

¹¹ See *infra* App. 10.

¹² See *infra* App. 11.

¹³ See *infra* § V; App. 8.

¹⁴ For example, this report does not address in detail issues relating to assumptions and factual diligence. Instead, the report focuses only on issues that have proven to be the most troublesome in practice.

C. How to Use this Report

Initially, lawyers who deal with remedies opinions should read this report itself, but not necessarily all of its appendices. This is designed to be a free-standing report, with the appendices available to provide additional detail as necessary. Three of the appendices are especially useful and important.

Appendix 4: Report of the Threshold Subcommittee. This systematically analyzes the costs and benefits of a remedies opinion. Although Appendix 4 is summarized in Section III below, the issues in it are so fundamental that it merits special attention.

Appendix 8: Application of Customary Practice to the Remedies Opinion. This is a significant departure from the approach taken in prior Business Law Section opinion reports. It provides a description of the legal diligence and competence customarily exercised to prepare and give remedies opinions. Lawyers should focus on conforming to these practices rather than debating whether the opinion covers “each and every” or “essential” provisions of the contract. Although Appendix 8 is summarized in Section V below, it merits special attention.

Appendix 10: Report of the Exceptions Subcommittee. Many opinion givers and lawyers for opinion recipients feel trapped by the ever-lengthening “laundry list” of separately stated exceptions in remedies opinions. Which exceptions need stating and which do not? Appendix 10 provides a framework for analyzing, shaping and reducing the “laundry list” of separately stated exceptions.

When developing or responding to a request for a remedies opinion in a particular transaction, this report could be especially helpful if used in the following manner.

First, read this report (but not the appendices), for an overview.

Second, if it is not clear from Section III below whether a remedies opinion is justified for the transaction, read Appendix 4 to help reach a decision.

Third, read the description of customary practice in Appendix 8 and apply that approach to the remedies opinion and relevant contracts.

Fourth, develop an appropriate list of exceptions that need stating, using the approach described in Section VII below and Appendix 10.

Fifth, decide whether a “generic exception” is appropriate, based on Section VIII below and Appendix 11.

III. THRESHOLD QUESTION: WHEN SHOULD A REMEDIES OPINION BE REQUESTED?

Despite numerous reports on third-party opinion practice, little has been published on the threshold question: When should a third-party remedies opinion be requested and given?

Implicit in reaching any conclusion on this question are answers to a series of additional questions: What benefits does the opinion recipient expect from a third-party remedies opinion? Are these benefits realizable? Do these benefits justify the costs of obtaining the opinion? Do negative consequences flow to the opinion giver's client or to the opinion recipient from a remedies opinion? Does the recipient have acceptable alternatives to a third-party remedies opinion? For example, would the opinion recipient do just as well or better with advice from its own counsel?

Appendix 4 is a report of the Threshold Subcommittee of the Opinions Committee appointed to address these questions. It concludes that, while receipt of a third-party remedies opinion certainly has benefits in many transactions, in many transactions those benefits are not sufficient to justify the costs (economic and other) that the preparation of the opinion entails. While remedies opinions continue to be included in many larger financing and merger and acquisition transactions, the incidence of their delivery has declined over the past decade, as parties and their counsel have recognized that the opinion is not cost-effective in a variety of transactions.

Ordinarily, the principal goal of a remedies opinion is to assist its recipient in evaluating legal risks in a transaction. However, where the recipient does not in fact rely on the opinion, the request for and issuance of a remedies opinion increases transaction costs without providing any real benefit. In such cases, a third-party remedies opinion should not be requested or given and the opinion recipient is better served by relying upon advice from its own counsel.

On the other hand, in many transactions a recipient may not be able to rely solely on the advice of its own counsel. This is often true, for example, in transactions with multiple parties, or in which the parties (or their counsel) are from different jurisdictions, the opinion recipient is not represented by separate counsel, or the opinion giver's client is a non-commercial or regulated entity. Additionally, in transactions involving complex or unusual structures, obtaining a remedies opinion from the opinion giver can provide comfort to the opinion recipient that the parties view the matter the "same way." Other factors affecting the analysis, such as the need for specialized knowledge, may be present in a particular transaction. Furthermore, with the advent of readily available access to the capital markets for securitization of various asset-backed financings, opinions have become the norm in certain types of transactions due to rating agency requirements. Thus, in many situations a third-party remedies opinion can provide cost-effective benefits. Even in those situations, however, it may be appropriate to limit the scope of the opinion.

The Threshold Subcommittee's report explores these issues and analyzes the types of costs and benefits involved in issuing third-party remedies opinions, so that practitioners have the tools to evaluate whether, and under what circumstances, the opinion should be sought and given. Clients (the opinion recipient, in discussion with the opinion giver's client) usually are the ultimate decision-makers concerning whether a third-party remedies opinion (or indeed any third-party opinion) will be requested. Lawyers should assist their clients to reach a sound decision by applying this cost-benefit analysis to the particular circumstances of their transaction.

IV. CUSTOMARY OPINION PRACTICE

Customary practice is the unifying tenet of recent literature discussing third-party closing opinions.¹⁵ It is used to provide guidance to lawyers in the negotiation, preparation and giving of opinion letters, and includes such factors as customary competence, customary diligence and customary usage. No other clearly articulated general standard is broadly accepted in opinion practice.¹⁶ As a result, opinion practice requires sensitivity to the need for a common understanding of the applicable customary practice by all lawyers involved in the process, as well as opinion recipients.

There are uncertainties inherent in the practical use of this standard. Customary practice where? Customary practice by whom? Do the lawyers involved in the transaction and the opinion recipient understand customary practice the same way? What resources can be used to determine customary practice?¹⁷ To provide a context for following portions of this report, Appendix 5 provides a discussion of customary practice as a general standard for legal opinions, and offers some suggestions on how to resolve these uncertainties.

In light of the volume of interstate transactions in which closing opinions are given, the Business Law Section supports movement toward a uniform national customary practice for the remedies opinion and encourages California lawyers to find guidance on customary practice regarding closing opinions in reports and other literature published in California and elsewhere.¹⁸

V. APPLICATION OF CUSTOMARY PRACTICE TO THE REMEDIES OPINION

For many years lawyers supporting the “California view” and those adhering to the “New York view” have disagreed over the meaning and scope of the remedies opinion. The California view, historically espoused by the California Business Law Section, is that a remedies opinion addresses the enforceability of only the “essential provisions” of a contract;¹⁹ the New York view, advocated by the New York-based TriBar Opinion Committee, is that it addresses “each and every” undertaking.²⁰

¹⁵ Am. Bar Ass’n. Comm. on Legal Opinions, *Legal Opinion Principles*, 53 Bus. Law. 831 (1998) [hereinafter *ABA Principles*], § 1.B; Am. Bar Ass’n. Comm. on Legal Opinions, *Guidelines for the Preparation of Closing Opinions*, 57 Bus. Law. 875 (2002) [hereinafter *ABA Guidelines*], at 875; *1998 TriBar Report* § 1.4; RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 95 comts. b, c & e (2000) [hereinafter *Restatement*].

¹⁶ An alternative to the use of the customary practice standard is to adopt into opinion letters specific standards provided by an external source. This is the approach of the ABA Accord, but the Accord has not achieved wide use.

¹⁷ Appendix 5 *infra* includes references to opinion literature, experience of the lawyers in the transaction, and surveys as examples of sources for customary practice. Importantly, in its discussion of surveys, Appendix 5 refers to a survey about remedies opinion conducted by the Opinions Committee with many California law firms in 2001 [hereinafter *2001 Survey*]. Appendix 6 *infra* is the form of the *2001 Survey*, and Appendix 7 *infra* is a summary of responses received. References to the *2001 Survey* are found in various appendices.

¹⁸ See *infra* App. 3.

¹⁹ *1989 Report* § V.C.

²⁰ *1998 TriBar Report* § 3.1.

The California view has at its base special concerns by some California opinion givers about liability for the remedies opinion,²¹ as well as concerns about burdensome transaction costs and risks of a damaged reputation. Those opinion givers believe that the “each and every” interpretation of the remedies opinion imposes an unduly burdensome legal diligence requirement either to know or to research the applicable law relating to the enforceability of every undertaking in the subject contract.²² Some of them also believe that California courts have an unusual tendency not to enforce literally the provisions of contracts.²³ In addition to embracing the “essential provisions” approach of the California view, some of these lawyers also seek to include in closing opinions long “laundry lists” of exceptions to the remedies opinion,²⁴ or a generic exception,²⁵ or both.

On the other hand, many opinion givers that adhere to the New York view not only advocate the “each and every” approach, but also include few separately stated exceptions in their opinions. They conclude that many exceptions taken by others need not be separately stated because the issue has been avoided by redrafting one or more contractual provisions or restructuring the transaction or, based on their understanding of customary usage, the legal concern (1) arises under a body of law that is generally understood not to be covered by the opinion, (2) is generally understood to be covered by the equitable principles limitation or bankruptcy exception, or (3) is of a nature that opinion givers customarily do not address it, as in the case of an economic remedy.²⁶ The New York view and these practices are also supported by many opinion recipients and their counsel, who feel it appropriate to ask for an opinion on every provision and to receive “streamlined” opinions in fulfillment of their diligence needs.

The Business Law Section believes that disagreement about the California view and the New York view has occupied an undue amount of time and energy, and should be discontinued. Appendix 8 explains why and provides a different approach to analyzing the liability, reputation and cost concerns that are the primary issues. It concludes that liability based on a breach of the duty of care is quite unlikely to be determined by whether the remedies opinion is interpreted to

²¹ See 1992 Report § III.G.2. A subcommittee of the Opinions Committee evaluated these concerns through legal research and surveys of insurance carriers and law firms. Its informal survey of insurance carriers of professional liability insurance indicated that, although carriers view opinion practice as a material source of risk as a component of a law firm’s risk profile, legal opinions have not historically been a significant source of professional negligence claims. The subcommittee, however, drew no general conclusions regarding lawyers’ liability for third-party legal opinions. In addition, recent anecdotal data seems to indicate that claims based on third-party legal opinions may be on the rise and that the magnitude of the claims can be quite substantial. In any event, California lawyers are not likely to change their practices in preparing and giving closing opinions, or their view of specific wording, based on a belief that the likelihood of liability for the opinion is slight.

²² See 1992 Report § III.G.2.

²³ *Ibid.*

²⁴ See *infra* § VII and App. 10.

²⁵ See *infra* § VIII and App. 11.

²⁶ 1998 TriBar Report §§ 3.3-3.5.

cover each and every provision of the contract or only the essential provisions. Rather, liability for breach of the duty of care owed to the opinion recipient will be determined by whether the opinion giver has complied with customary practice in preparing and rendering the remedies opinion.²⁷

It appears that most experienced opinion givers, regardless of their geographic location or adherence to one or the other view, exercise similar customary practice in preparing and giving remedies opinions. That customary practice is described in Appendix 8. Remedies opinions prepared and given in accordance with this customary practice are usually cost efficient, and should satisfy the legitimate diligence needs of opinion recipients for an informed professional judgment.

VI. CALIFORNIA “ENFORCEABILITY” ISSUES: ARE CALIFORNIA COURTS DIFFERENT?

One explanation for the historical difference of approach between the California view and the New York view is a perception by some California opinion givers that California law is significantly different from the law in other states (especially New York). Some have argued that California courts have an unusual tendency not to enforce contract provisions literally when confronted with concerns about harsh or inequitable results. They claim that California courts are much quicker than others to apply such principles as an implied covenant of good faith and fair dealing and exceptions to the parol evidence rule in order to “do justice” in the face of contrary written contractual provisions. As a result, they argue, it is harder to rely on the written words in agreements governed by California law, and thus to give an opinion that each and every contractual provision is enforceable in accordance with its terms.

The Opinions Committee appointed a subcommittee to study the issue of whether significant differences exist between the laws and courts of California and New York in the enforcement of contracts. Its report is attached as Appendix 9. After acknowledging the inherent limitations in a broad inquiry of this type, the subcommittee reports that it did not find support for the common perception of a wide gap between California and New York in the enforcement of contracts. In sum, the courts of both California and New York, in applying the laws of their states, show a similar strong proclivity to enforce contracts in accordance with their terms subject to some important shared legal limitations.

VII. EXCEPTIONS

Opinion givers almost always include exceptions in remedies opinions. As noted in Section V above, some California lawyers include a long “laundry list” of separately stated exceptions, and also in some circumstances include a generic exception.²⁸ These lawyers are usually motivated by concerns about liability, cost effectiveness and reputation issues, and the

²⁷ There are of course other possible theories of liability for a remedies opinion, *e.g.*, fraud, negligent misrepresentation, and aiding and abetting the wrong of another.

²⁸ *See infra* § VIII.

possibility that a court might interpret a remedies opinion as covering each and every provision of a contract, including some provisions that are not always enforceable. This practice contrasts with the tendency of many lawyers in other jurisdictions to use fewer separately stated exceptions, and with support found in Bar reports and other opinion literature for more streamlined opinions.²⁹

An exception to a remedies opinion points out to the opinion recipient that the opinion giver has at least a significant uncertainty that one or more contractual undertakings are enforceable, and it limits the opinion's coverage of (and the opinion giver's responsibility for) those provisions.³⁰ Whether a separately stated exception is required for a particular undertaking depends in part on whether, by customary usage (i.e., what words in the opinion are generally understood to mean³¹), the issue giving rise to the uncertainty is outside the opinion's coverage. For example, the equitable principles limitation is generally understood to exclude from the opinion the enforceability of remedies that may be specified in the contract in circumstances where a breach is immaterial or the party seeking enforcement is not acting in good faith, so that stated exceptions on these points are not necessary.

The Exceptions Subcommittee of the Opinions Committee addressed the question of the use of exceptions (except for the generic exception, which is discussed in Section VIII below), and the report of its work is set forth in Appendix 10.

Two exceptions almost always expressed in relation to remedies opinions are the bankruptcy exception and the equitable principles limitation.³² Appendix 10 explores the meaning and scope of these exceptions.

Appendix 10 also surveys many commonly found contractual undertakings and assesses whether an opinion on their enforceability should be limited or excluded from remedies opinions in separately stated exceptions. These "survey provisions" are drawn from other opinions reports³³ and the 2001 Survey,³⁴ and in general are found in a typical credit agreement.

²⁹ See *infra* App. 3. See also The TriBar Opinion Committee, *The Remedies Opinion -- Deciding When To Include Exceptions And Assumptions*, 59 Bus. Law. 1483 (2004).

³⁰ It is inappropriate to express an exception that does not relate to any undertaking in the contract opined on. *ABA Guidelines* § 1.3.

³¹ See *infra* App. 5.

³² It is customarily understood that the bankruptcy exception and equitable principles limitation are included with a remedies opinion, even if unstated. See *infra* App. 10 § I.A; *1998 TriBar Report* § 3.3.1.

³³ *Accord Report* § 14, "Other Common Qualifications," and *1992 Report* § III.C.(c), "California Qualifications."

³⁴ *2001 Survey* participants were asked whether they customarily express exceptions with respect to contractual provisions listed in the survey, and to identify other provisions as to which legal issues give rise to exceptions. See *infra* App. 6.

The Exceptions Subcommittee first considered California law applicable to each of the survey provisions and assessed whether that review raised a significant enforceability question. If so, the subcommittee then evaluated whether that question is (or should be) customarily addressed by a separately stated exception. The subcommittee considered whether the legal issue that could give rise to the exception is as a matter of customary practice outside the opinion's coverage. Each survey provision was then placed into one of the following categories:

1. **“Equitable Principles Limitation”**: The survey provision generally is not enforceable as written. No separate exception is necessary, however, because, as a matter of customary usage, the equitable principles limitation is understood to include the principal basis that would cause the survey provision not to be enforceable.³⁵
2. **“Generally Enforceable”**: The survey provision is generally enforceable.³⁶ Consequently, a separate exception is not necessary and should not be taken.
3. **“Exception Sometimes Required”**: There may be limited circumstances in which courts will not enforce the survey provision as written; but only if those circumstances are present is it appropriate to take a separate exception.³⁷
4. **“Exception Usually Required”**: The survey provision is generally unenforceable and is not within category 1 above. An exception, if deemed to be appropriate under the circumstances, should be separately stated.³⁸

The subcommittee's categorization of the survey provisions is summarized in a table in Section III of Appendix 10, which is duplicated here for ease of reference. Please refer to

³⁵ The reasons for which the survey provision is not enforceable do not depend upon the circumstances in which enforcement is sought. The survey provision, if given effect, would negate the application of a mandatory equitable principle--for example, it purports to permit a party to act in bad faith.

³⁶ The survey provision, as written, is generally enforceable. Circumstances might arise after the agreement becomes effective, however, that would prevent the survey provision from being enforced as written. One such circumstance--the subsequent bankruptcy of the obligor--is covered by the bankruptcy exception. Other such circumstances might make it inequitable to enforce the survey provision as written--for example, by reason of laches. Unenforceability for this reason is covered by the equitable principles limitation. (N.B.: “Generally Enforceable”, in this context, also does not address reasons for which the survey provision might not be enforced that are beyond the scope of the opinion. *See, e.g., infra* App. 10, “Law Covered by Remedies Opinion”, under “Further Notes.”)

³⁷ Although the survey provision is often enforceable, there exist circumstances under which a court might refuse to enforce the survey provision for reasons that, as a matter of customary usage, are understood *not* to be encompassed by either the bankruptcy exception or the equitable principles limitation, and, if an exception is believed to be appropriate under the circumstances, it should be separately stated. This does not mean that, in all cases, the inclusion of the survey provision in an agreement that is being opined upon should result in an exception being taken with respect to the survey provision.

³⁸ The survey provision is generally unenforceable for reasons that, as a matter of customary usage, are understood *not* to be encompassed by either the bankruptcy exception or the equitable principles limitation, and not to be beyond the scope of the opinion.

Appendix 10 for an explanation of this table, including a full description of the survey provisions.

CLASSIFICATION

Equitable Principles Limitation	Generally Enforceable	Exception Sometimes Required	Exception Usually Required
Waivers of obligations of good faith and fair dealing	Choice of law	Remedies cumulative	Covenants not to compete
	Time is of the essence		Provisions for penalties, liquidated damages, prepayment charges, late charges, and the like
Waivers of right to cure (where harm not material)	Forum selection/ consents to jurisdiction	Arbitration provisions	Confessions of judgment
Exercise of remedies without consideration of materiality and consequences of breach	Appointment of attorney-in- fact	Indemnities/releases	Waivers of (i) broadly or vaguely stated rights; (ii) statutory, regulatory, or constitutional rights, except as permitted; (iii) unknown future defenses; or (iv) damages
	Severability	Unconscionable provisions	
	Prohibition of oral modifications		
Exercise of remedies without considering impracticability or impossibility due to unforeseen circumstances	Self-help remedy provisions	Waivers of statutes of limitation	Changes/waivers of rules of evidence or method or quantum of proof to be applied in litigation
	Rights of setoff		Appointment of receiver
	Payments free of setoff, counterclaim or defense		Waivers of jury trials
			Waivers of guarantor’s defenses
			Attorneys’ fees to one party only
			Indemnification for securities law liabilities

The subcommittee's reasons for these categorizations are set forth in Annex A (and accompanying discussion in Annex B) of Appendix 10. In summary, many of the exceptions commonly included by California opinion givers in their laundry lists need not be separately listed.

VIII. THE GENERIC EXCEPTION

In addition to the equitable principles limitation, the bankruptcy exception and separately stated exceptions discussed in Section VII above and Appendix 10, a general exception known as

a “generic exception” is sometimes included in closing opinions with remedies opinions. A customary formulation of the generic exception in transactions other than real estate secured loans³⁹ is as follows:

The opinion regarding enforceability set forth above is subject to the qualification that certain provisions of the contract covered by this opinion letter may be unenforceable, but such unenforceability will not[, subject to the other exceptions, qualifications and limitations in this opinion letter,] render the contract invalid as a whole or substantially interfere with realization of the principal benefits provided by the contract.⁴⁰

The Generic Exception Subcommittee of the Opinions Committee examined issues related to the formulation and use of the generic exception. Its report is attached as Appendix 11. The report includes a discussion of various problems raised by the formulation of the generic exception and the range of transactions in which it is customarily used. It also addresses a related issue - the request for an opinion giver to provide “general assurance” that, notwithstanding all the exceptions and limitations otherwise stated with respect to the remedies opinion, the opinion recipient has available to it “legally adequate remedies for the realization of the principal benefits intended to be provided” by the contracts covered by the remedies opinion.

In summary, the report reaches the following conclusions:

1. A generic exception is customary with respect to remedies opinions in real estate secured loans and other complex asset-based transactions, and may be appropriate in other types of complex transactions.
2. It is not customary to include a generic exception in a remedies opinion simply as a means to limit the opinion’s coverage to “essential provisions.”⁴¹
3. Uncertainties are inherent in any formulation of the generic exception. The formulation of the generic exception stated above provides a method of balancing the concerns of opinion givers and opinion recipients in transactions in which a generic exception is used.
4. It is neither customary nor appropriate to request or give “general assurance” language referred to above.

³⁹ The real estate bar has developed more specific formulations of the generic exception for use in connection with real estate secured loans. *See infra* App. 11 n. 3.

⁴⁰ *Infra* App. 11 § I & n. 1. The bracketed language in this formulation of the generic exception is customarily understood, whether or not stated.

⁴¹ For discussion of the “essential provisions” view of the remedies opinion, contrasting it with the “each and every” view, *see supra* § V and *infra* App. 8.

IX. CONCLUSION

Frustration over the burdens placed on transactions by third-party closing opinions, especially remedies opinions, is understandably high. By using the tools provided in this report, opinion givers and counsel for opinion recipients can make the opinion process a better communications tool and substantially reduce those burdens, for the benefit of themselves and their clients.

APPENDIX 1

GLOSSARY

Glossary

1987 Real Property Report – Joint Committee of the Real Property Law Section of the State Bar of California and the Real Property Section of the Los Angeles County Bar Association, *Legal Opinions in California Real Estate Transactions*, 42 Bus. Law. 1139 (1987).

1989 Report – Committee on Corporations of the Business Law Section of the State Bar of California, *1989 Report of the Committee on Corporations of the Business Law Section of the State Bar of California Regarding Legal Opinions in Business Transactions (August 1989)*, 45 Bus. Law. 2169 (1990).¹

1992 Report – Business Law Section of the State Bar of California, *Report on the Third-Party Legal Opinion Report of the ABA Section of Business Law (May 1992)*.

1998 TriBar Report – The TriBar Opinion Committee, *Third-Party "Closing" Opinions*, 53 Bus. Law. 591 (1998).

2001 Statement – Business Law Section of the State Bar of California, *Statement of the Business Law Section of the State Bar of California (January 2001)*.

2001 Survey – A survey conducted by the Opinions Committee regarding customary practices in California concerning third-party remedies opinions. The survey questions used in the 2001 Survey are set forth in **Appendix 6**, and the results of the 2001 Survey are set forth in **Appendix 7**.

2002 Compendium – Business Law Section of the State Bar of California and Real Property Law Section of the State Bar of California, *2002 California Opinion Reports*. The 2002 Compendium contains the following reports and statements:

- 1987 Real Property Report.
- UCC Report.
- 1989 Report.
- Joint Committee of the Real Property Law Section of the State Bar of California and the Real Property Section of the Los Angeles County Bar Association, *Legal Opinions in California Real Estate Transactions: An Addendum* (March 14, 1990).
- 1992 Report.

¹ As of September 2004, the Committee on Corporations of the Section is preparing a report that revises and restates the 1989 Report..

- Joint Committee of the Real Property Law Section of the State Bar of California and the Real Property Section of the Los Angeles County Bar Association, 1995 California Real Property Legal Opinion Report.
- Joint Committee of the Real Property Law Section of the State Bar of California and the Real Property Section of the Los Angeles County Bar Association, First Supplement to 1995 California Real Property Legal Opinion Report (1998).
- Partnerships and Limited Liability Companies Committee of the Business Law Section of the State Bar of California, Report on Legal Opinions Concerning California Partnerships (February 1998).
- Partnerships and Limited Liability Companies Committee of the Business Law Section of the State Bar of California, Report on Legal Opinions Concerning California Limited Liability Companies (February 2000).
- 2001 Statement.
- Joint Committee of the Real Property Law Section of the State Bar of California and the Real Property Section of the Los Angeles County Bar Association, Statement of the Joint Committee of the Real Property Law Section of the State Bar of California and the Real Property Law Section of the Los Angeles County Bar Association (May 2001).
- Joint Committee of the American Bar Association, Section of Real Property, Probate and Trust Law, Committee on Legal Opinions in Real Estate Transactions, Subcommittee on Creation of an Inclusive Opinion, and the American College of Real Estate Lawyers Attorneys' Opinion Committee, Inclusive Real Estate Secured Transaction Opinion in which are Incorporated the Principal Concepts of the ABA Section of Real Property, Probate and Trust Law and the American College of Real Estate Lawyers Report on Adaptation of the Legal Opinion Accord.

ABA – American Bar Association.

ABA Committee – Committee on Legal Opinions, American Bar Association.

ABA Guidelines – Committee on Legal Opinions, American Bar Association, *Guidelines for the Preparation of Closing Opinions*, 57 Bus. Law. 875 (2002).

ABA Principles – Committee on Legal Opinions, American Bar Association, *Legal Opinion Principles*, 53 Bus. Law. 591 (1998).

Accord – The "Legal Opinion Accord" contained in the **Accord Report**.²

² The Accord is occasionally referred to as the "Silverado Accord," as the drafting committee of the Accord Report held its first conference at the Silverado resort in Napa, California.

Accord Report – Committee on Legal Opinions, American Bar Association, *Third-Party Legal Opinion Report, Including the Legal Opinion Accord*, 47 Bus. Law. 167 (1991).

assumption – An assumption applicable to an opinion regarding a matter of fact, a matter of law or a matter of both fact and law. Some assumptions are specifically stated in an opinion letter, while others are "understood" and may or may not be specifically stated. *Compare exception.*

bankruptcy exception – An exception to an opinion excluding from the opinion the effect of bankruptcy, insolvency, reorganization, receivership, moratorium and other similar laws affecting the rights and remedies of creditors generally. *Appendix 10* discusses the bankruptcy exception.

Business Law Section – The Business Law Section of the State Bar of California.

California Qualifications – the "California Qualifications" set forth in the *1992 Report*.

California UCC or Cal. UCC – The Uniform Commercial Code, as adopted in California.³

closing opinion – *See* opinion letter.

equitable principles limitation – An exception to an opinion excluding from the opinion the effect of general principles of equity, whether applied by a court of law or equity. *Appendix 10* discusses the equitable principles limitation.

exception – An exception, limitation, qualification or exclusion to a legal opinion. Some exceptions are specifically stated in an opinion letter (such exceptions are frequently referred to as a "laundry list" when they are numerous), while others are "understood" and may or may not be specifically stated. *See also bankruptcy exception* and *equitable principles limitation*. *Compare assumption.*

general assurance – A statement supplementing a remedies opinion expressing (notwithstanding all the exceptions otherwise stated in a remedies opinion) that the opinion recipient has available to it "legally adequate remedies for the realization of the principal benefits intended to be provided" (or similar language) by the contracts covered by the remedies opinion. A general assurance is inappropriate in a remedies opinion, and an opinion recipient should not request one. *Appendix 11* discusses general assurances.

generic exception – An exception to a remedies opinion stating that certain provisions contained in an agreement may be limited or rendered ineffective or unenforceable by reason of applicable laws and judicial decisions governing such provisions. *Appendix 11* discusses the generic exception.

³ As the consequence of statutory naming conventions in California, the California UCC contains "Divisions" instead of "Articles." Divisions 1 through 9 of the California UCC correspond to the identical Article numbers of the Uniform Commercial Code, as published by the National Conference of Commissioners on Uniform State Laws (the "UCC"). Division 10 of the California UCC corresponds to Article 2A of the UCC. Division 11 of the California UCC corresponds to Article 4A of the UCC.

Glazer, FitzGibbon & Weise – Donald W. Glazer, Scott FitzGibbon & Steven O. Weise, *Glazer and FitzGibbon on Legal Opinions: Drafting, Interpreting and Supporting Closing Opinions in Business Transactions* (2d ed. 2001).

laundry list – The list of separately stated exceptions to a remedies opinion (sometimes used to refer to a very long or overly cautious list). **Appendix 10** discusses whether it is or should be customary practice to state exceptions to survey provisions separately.

opining jurisdiction – a jurisdiction whose applicable law an **opinion giver** addresses in an **opinion letter**. If there is more than one such jurisdiction (e.g., the United States and a particular state), the term refers collectively to all.

opinion giver – The lawyer or law firm in whose name the opinion letter is signed.

opinion letter – A letter, generally delivered at the closing of a business transaction, delivered by counsel for one party to the transaction to the other party, that expresses counsel's conclusions on various matters of legal concern to that other party. As the opinion giver does not deliver the opinion letter to its own client, but rather to another party at a closing, an opinion letter is also referred to as a "third-party" legal opinion or a "closing" opinion.

opinion preparers – The lawyers in a law firm who take on the responsibility to prepare an opinion letter.⁴

opinion recipient – The addressee of the opinion letter and others, if any, granted permission by the opinion giver to rely on the opinion letter. The opinion recipient ordinarily receives the letter as a participant in a business transaction.

Opinions Committee – The Opinions Committee of the Business Law Section of the State Bar of California. **Appendix 2** sets forth a list of the current members of the Opinions Committee.

Other Common Qualifications – The "Other Common Qualifications" described in the *Accord*.

remedies opinion – An opinion concerning whether the provisions of an agreement will be given effect by the courts. A remedies opinion is also frequently referred to as an enforceability opinion.

Restatement – American Law Institute, *Restatement (Third) of the Law Governing Lawyers* (2000).

Section – The Business Law Section of the State Bar of California.

survey provisions – Certain commonly found contractual undertakings drawn from other opinions reports and the **2001 Survey**. **Appendix 10** discusses the survey provisions.

⁴ If a particular lawyer takes responsibility only for a specific opinion, for example, a lawyer specializing in Uniform Commercial Code matters with regard to a perfection opinion, that lawyer is an opinion preparer only as to that opinion and not as to all the other opinions in the opinion letter.

TriBar or the TriBar Committee – The TriBar Opinion Committee, which includes members of the following organizations functioning as a single committee: (i) Special Committee on Legal Opinions in Commercial Transactions, New York County Lawyers' Association; (ii) Corporation Law Committee, The Association of the Bar of the City of New York; and (iii) Special Committee on Legal Opinions of the Business Law Section, New York State Bar Association. In recent years, members from some states other than New York have joined the committee.

UCC Report – Uniform Commercial Code Committee of the Business Law Section of the State Bar of California, *Report Regarding Legal Opinions in Personal Property Secured Transactions* (December 1988), 44 Bus. Law. 791 (1989).

Umbrella Report – Business Law Section of the State Bar of California, *Report on Third-Party Remedies Opinions* (September 2004). The ***Umbrella Report*** refers to the report itself, but not its appendices.

undertaking – a specific promise in a contract or agreement, as opposed to the entire contract or agreement. Thus, a contract or agreement typically contains many "undertakings."

APPENDIX 2

MEMBERS OF THE BUSINESS LAW SECTION OPINIONS COMMITTEE

APPENDIX 2

MEMBERS OF THE BUSINESS LAW SECTION OPINIONS COMMITTEE

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APPENDIX 3

STATEMENT OF THE BUSINESS LAW SECTION OF THE STATE BAR OF CALIFORNIA

STATEMENT OF THE BUSINESS LAW SECTION OF THE STATE BAR OF CALIFORNIA¹

The Business Law Section of the State Bar of California and its committees have issued several important reports providing guidance to California lawyers rendering third party legal opinions² on California law and lawyers advising recipients of California opinions. These reports include³:

- Report Regarding Legal Opinions in Personal Property Secured Transactions (December 1988) (the “UCC Report”)
- 1989 Report of the Committee on Corporations Regarding Legal Opinions in Business Transactions (August 1989) (the “1989 Report”)
- Business Law Section Report on the Third-Party Legal Opinion Report of the ABA Section of Business Law (May 1992) (the “1992 Report”)⁴
- Report on Legal Opinions Concerning California Partnerships (February 1998) (the “Partnership Report”)
- Report on Legal Opinions Concerning California Limited Liability Companies (February 2000) (the “LLC Report”)

The 1989 Report and the UCC Report, as well as two reports of a joint committee of the California Real Property Law Section and the Real Property Section of the Los Angeles County Bar Association,⁵ were collected and distributed in a blue booklet entitled 1990 California

¹ The Executive Committee of the Business Law Section appointed an Opinions Task Force in the Spring of 2000 to review Section’s policy as embodied in the Section’s reports on third party legal opinions, in light of recent publications and proposed updating of Section reports. The Task Force is comprised of John B. Power, Chair, R. Bradbury Clark, Nelson D. Crandall, Richard N. Frasch, Jerome A. Grossman, Morris W. Hirsch, Henry Lesser, Carol K. Lucas, Steven J. Tonsfeldt, Benzion J. Westrich, and Steven O. Weise; *ex officio* members Twila L. Foster and Ann Yvonne Walker; and advisor Robert Thompson. This statement was adopted by the Task Force and approved by the Executive Committee in December 2000.

² A “third party legal opinion” is addressed to a non-client at the request or with the consent of a client of the opinion giver. It is typically used by an opinion recipient in a business transaction as part of its “due diligence.”

³ The reports listed below are referred to in this Statement as the “California Reports.”

⁴ This report provides guidance for those adopting the ABA “Legal Opinion Accord” in California opinions (and includes valuable references to many relevant California legal authorities, as of its date). Adoption of the Accord in an opinion results in agreement that definitions, procedures and limitations provided by the Accord govern the opinion. The Accord is found in *Third-Party Legal Opinion Report, Including the Legal Opinion Accord, of the Section of Business Law, American Bar Association*, 47 Bus. Law. 167 (1991) (the “ABA Accord Report”). Although some lawyers adopt the Accord, it apparently has not achieved wide acceptance; however, many lawyers use the ABA Accord Report for the light it sheds on issues arising in opinion practice. See also *1995 California Real Property Legal Opinion Report*, Joint Committee of the Real Property Section of the State of California and the Real Property Section of the Los Angeles County Bar Association, 13 California Real Property Jnl., No. 3, 1 (1995) (the “1995 Real Estate Report”), and *First Supplement to 1995 California Real Property Legal Opinion Report*, 16 California Real Property Jnl., No. 1, 15 (1998) (the “First Supplement to the 1995 Real Estate Report”), providing guidance for lawyers adopting the Accord in opinions in real estate transactions (as well as useful legal analysis).

⁵ These reports are *Legal Opinions in California Real Estate Transactions*, 42 Bus. Law. 1139 (1987) and *Joint Committee Report – an Addendum* (March 1990).

Opinion Reports. At the time of issuance of this Statement, the booklet is under revision to add the 1992 Report, the 1995 Real Estate Report⁶, the First Supplement to the 1995 Real Estate Report⁷, the Partnership Report and the LLC Report.

Other resources. Portions of the 1989 Report and the UCC Report are out-of-date and do not fully reflect such factors as changes in law, possible changes in opinion practice, and the impact of more recent opinion literature; other portions continue to provide useful guidance. Standing committees of the Business Law Section are reviewing these reports, and likely will issue updated reports.⁸ The Partnership Report and the LLC Report are more current, but rely on the 1989 Report for guidance on opinion issues beyond partnership and limited liability company issues.

The Business Law Section encourages California practitioners to use the California Reports,⁹ but to do so in conjunction with other recent resources. In this connection, the Section draws attention particularly to the following:

- The American Law Institute’s Restatement (Third) of the Law Governing Lawyers (2000) (the “Restatement”),¹⁰ particularly §§ 51, 52 and 95
- Legal Opinion Principles, issued by the Committee on Legal Opinions of the American Bar Association Section of Business Law, 53 Bus Law. 831 (1998) (the “ABA Principles”)
- Guidelines for the Preparation of Closing Opinions, in the process of issuance by the Committee on Legal Opinions of the American Bar Association Section of Business Law in January 2001 (the “ABA Guidelines”), replacing Certain Guidelines for the Negotiation and Preparation of Third-Party Legal Opinions, contained in the ABA Accord Report¹¹
- Third Party Closing Opinions, issued by the New York TriBar Committee, 53 Bus Law. 591 (1998) (the “TriBar Report”).

Customary practice. Among other things, these other resources emphasize the importance of customary practice in the preparation,¹² negotiation and interpretation of third party legal opinions in business transactions. The Business Law Section concurs with their position that customary practice is and should be a very important guiding consideration for both opinion givers and recipients.

⁶ See Footnote 4.

⁷ See Footnote 4.

⁸ The Opinions Task Force (see Footnote 1) proposes to review references to authorities in the 1992 Report to determine whether they need updating. See Footnote 4.

⁹ See Footnote 3.

¹⁰ The Restatement focuses on legal standards rather than practice matters.

¹¹ See Footnote 4. The ABA Guidelines are expected to be published in the May 2001 edition of *The Business Lawyer*.

¹² For example, legal and factual diligence and the form of the opinion. Significantly, these resources remind opinion givers of the importance and scope of diligence in the preparation of legal opinions.

The Restatement is likely to become a very important source for determining the duty of care owed to recipients by opinion givers, and therefore its references to customary practice are particularly noteworthy. The Restatement cites¹³ the ABA Principles and the TriBar Report in its discussion of third party legal opinions (including several references to customary practice). The ABA Principles, the ABA Guidelines, and the TriBar Report discuss specific aspects of customary practice. Although local practices have differed in the past in certain respects and may continue to differ,¹⁴ these publications provide a helpful description of customary practice as understood and followed by a large segment of U.S. practitioners.

Customary practice, as described in the Restatement and the TriBar Report, recognizes that opinion letters need not recite disclaimers, qualifications or assumptions that are customarily understood to apply even when they are not expressly stated. Different lawyers have followed different practices with regard to how much to state expressly in their opinions. The Business Law Section believes that the omission of customarily understood disclaimers, qualifications and assumptions is desirable, and endorses the trend toward more streamlined opinion letters.

Any attempt to identify and articulate general standards for opinions necessarily involves some uncertainty. Examples of this uncertainty in relation to customary practice include: 1) how a practitioner knows or can determine what customary practice is with respect to a particular point, 2) whether the opinion giver and the opinion recipient (and its counsel) understand customary practice the same way, and 3) where customary practice varies, which practice should be followed. This should not, however, discourage the effort to achieve uniformity.

Conclusion. The Business Law Section encourages practitioners giving and advising recipients regarding legal opinions on matters of California law to consult the California Reports, the Restatement, the ABA Principles, the ABA Guidelines, and the TriBar Report in their opinion practice. The Section supports the importance of following customary practice, as stressed in the latter four documents. In the case of the ABA Principles, the ABA Guidelines, and the TriBar Report, the Section also supports their effort to address the concerns in the preceding paragraph, and to promote uniformity, by describing important aspects of current customary practice. The Business Law Section believes it is important to continue this effort.

¹³ Reporter's Note to Comment b to Section 95; Reporter's Note to Comment c (lawyer's duty to third-party recipient).

¹⁴ For example, in 1989, the Committee on Corporations of the California Business Law Section interpreted an opinion on the enforceability of an agreement as covering only compliance with California law that would invalidate any essential provision of the agreement (the 1989 Report, at p. 31); in 1998, the TriBar Committee reiterated its view that such an opinion covers each undertaking of the client in the agreement (TriBar Report, 53 Bus. Law., at 621). The Opinions Task Force or another committee of the Business Law Section is likely to study, in the near future, the question whether and to what extent customary practice in California and New York currently differs on this question.

APPENDIX 4

REPORT OF THE THRESHOLD SUBCOMMITTEE

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I. INTRODUCTION

A. Third-Party Remedies Opinions

Much has been written in the recent past about third-party closing opinions in business transactions.¹ Opinions reports generally deal with the meaning and scope of opinions, and the customary practice followed prior to issuing certain parts of the opinion. While there is some discussion of the appropriateness of requests for various types of opinions, comparatively little attention has been focused on the purposes, risks and costs of remedies opinions. Often, lawyers and their clients request a remedies opinion from counsel for another party in the transaction without engaging in the recommended cost/benefit analysis.² Lawyers requesting the opinion frequently rely on the overused flippant comment that “it is market” to receive a remedies opinion and believe that this is the only analysis required.³ The Business Law Section is of the view that lawyers should not recommend that a client request a third-party remedies opinion that will result in significant costs unless a clear benefit that justifies the costs is likely to be enjoyed by their client.

Practitioners in California report fewer requests for remedies opinions than historically have been made, especially in public merger and acquisition transactions and in smaller transactions. Even in small financing transactions, such opinions are regularly dispensed with.⁴ Presumably, clients and their counsel are beginning to recognize that the cost of a remedies opinion is often disproportionate to the value obtained by the opinion recipient.

The principal question addressed in this appendix is: What are the considerations in determining whether to request or give a remedies opinion? Implicit in reaching any conclusions on this question is a series of additional questions:

¹ For a list of relevant reports, see Bus. Law Section of the State Bar of Cal., *Statement of the Business Law Section of the State Bar of California*, 21 Bus. L. News 14 (2001) [hereinafter *2001 Statement*], attached *supra* as Appendix 3.

² See The Am. Bar Ass’n Comm. on Legal Opinions, *Report: Guidelines for the Preparation of Closing Opinions*, 57 Bus. Law. 875, § 2.2 (2002) [hereinafter *ABA Guidelines*] (“An opinion of other counsel should be sought by the opinion recipient only when the opinion’s benefits justify its costs.”). This cost/benefit analysis applies to all opinions contained in a third-party opinion letter (including whether to request such a letter at all), not just the remedies opinion. Applying the analysis to third-party opinions other than the remedies opinion is outside the scope of the Umbrella Report.

³ See *ABA Guidelines* § 1.6: (“An assertion that a specific opinion is ‘market’—i.e., that lawyers are rendering it in other transactions—does not make it appropriate to request or render such an opinion if it is inconsistent with these Guidelines.”)

⁴ An informal survey conducted among members of the Subcommittee responsible for this Appendix suggests that third-party remedies opinions are not being delivered in most transactions (other than lending transactions) involving less than \$10 million. Opinions almost always are requested by lenders in loan transactions exceeding \$100 million. Delivery of third-party remedies opinions is reported in most M&A transactions involving \$10 million or more (except in merger transactions between public companies, where the practice seems to differ). Remedies opinions apparently are given in many private securities transactions. The survey did not seek explanations for the results reported. Possibly, the practice of giving third-party remedies opinions in M&A and securities issuance transactions results from the fact that closing opinions on other subjects are customarily required, and giving a remedies opinion may be perceived as involving little additional effort by the opinion giver. Finally, some members of the Subcommittee reported that a few large institutional lenders active in the California market have de-emphasized receipt of a remedies opinion in many of their loan transactions involving lender-prepared documents, and in real estate construction loan transactions. These trends may signal a general change in approach to third-party remedies opinions.

(1) What expected benefits are provided to the opinion recipient and under what circumstances are these benefits likely to be actually achieved?

(2) Do any negative consequences flow to the opinion giver's client or to the opinion recipient from delivery or receipt of a remedies opinion?

(3) Can the benefits be obtained in ways that are less "costly" than the issuance of a third-party remedies opinion?

B. Primary Purpose

The principal purpose of a closing opinion is to assist the opinion recipient's due diligence in determining whether to enter into a transaction on the business terms discussed by the parties.⁵

In light of this purpose, lawyers requesting a remedies opinion need to be mindful that a remedies opinion should only be sought when its benefit justifies its cost.⁶ Often, especially in transactions that are routinely entered into by it, the opinion recipient (and its counsel) are most knowledgeable about enforceability of the relevant contracts. It may well be more economic and efficient for that party to rely on the advice of its own counsel rather than to request the opinion of the counterparty's counsel, even if the counterparty has agreed to pay the fees and costs of the opinion recipient's counsel.⁷ As summarized by the Restatement: "It would often be wasteful or impractical for the other party to the transaction . . . to assess a legal issue that could be determined more readily by the lawyer for the client."⁸

Since the primary purpose of a remedies opinion is to assist in due diligence for the transaction, the request for a remedies opinion should have as its principal goal the identification of legal enforceability issues regarding specific contract provisions, or the existence of a potential legal defense to the contract as a whole. Unenforceability issues that pertain to the text of the document, in contrast to problems that arise as a result of circumstances particular to one or more parties to the contract, are usually as easily ascertained by the opinion recipient's counsel as the opinion giver. In the vast majority of transactions, a third-party remedies opinion does not result in the identification of enforceability issues unknown to the opinion recipient or its counsel. On the other hand, a request for a remedies opinion frequently produces lengthy

⁵ *ABA Guidelines*, § 1.1.

⁶ *See Id.* § 2.2; *Report of the Committee on Corporations Regarding Legal Opinions in Business Transactions* [hereinafter, *1989 Report*], § IV.B.1. As of September 2004, the Corporations Committee of the Section is preparing a report that revises and restates the *1989 Report*. The new report, however, will not address remedies opinions except by reference to the Umbrella Report and its appendices, which collectively supersede the relevant portions of the *1989 Report*.

⁷ In assessing whether the benefit of a remedies opinion "justifies its cost," the focus should not be simply on measuring cost from the opinion giver's client's perspective--any cost incurred by a party in having its counsel issue a third-party opinion is greater than that person would have otherwise borne. Rather, the inquiry should be whether the aggregate costs to all parties are greater either because of the duplication of effort (as counsel for both parties may be giving opinions or advising on the same subject), or because of the economic cost of the negotiation over the text of the opinion itself. In many business transactions, the clients collectively want the aggregate legal fees to be as low as possible consistent with obtaining effective legal representation. Because the cost of both counsel is frequently borne by one party, it is particularly important to that party that total costs of the transaction be kept as low as possible.

⁸ RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 95, cmt. b (2000) [hereinafter RESTATEMENT].

discussions between counsel regarding the extent and nature of the exceptions that will be included in relation to the remedies opinion.

However, as discussed elsewhere⁹, in many situations the principal purpose of the remedies opinion is to offer legal comfort to a party not separately represented by counsel, for example, a rating agency or another person who is not a party to the contract. Further, in some situations the opinion involves issues that the opinion giver is better suited to address than the opinion recipient's counsel. In those and other cases, the benefit obtained by the opinion recipient is substantial and is likely to justify the cost of the remedies opinion.

Ultimately, the decision whether a third-party remedies opinion will be given in a transaction should be made by the clients (and not just the lawyers). However, since costs and benefits of remedies opinions are much more familiar to lawyers than to most clients, opinion givers and counsel to opinion recipients should assist their clients in making this cost/benefit analysis.

C. Consideration of Alternatives

This appendix focuses mainly on whether to include a third-party remedies opinion as part of the due diligence in a transaction. That is just one point along a decision tree with many branches. The alternatives are as many and varied as the diversity of transactions and creativity of lawyers can make them. Here are some of the possibilities.

(1) Dispense with a third-party legal opinion altogether. Alternative sources of due diligence may be sufficient and more cost-effective.¹⁰

(2) Obtain a third-party opinion as to matters such as due organization, authorization, execution and delivery, but not obtain a remedies opinion.¹¹

(3) Obtain a remedies opinion from the lawyer for the opinion recipient, rather than another party's lawyer.¹²

(4) Even if a third-party remedies opinion is given, limit its scope:

(a) It could cover some but not all of the transaction documents.¹³

(b) It could cover some but not all provisions of a complex, multifaceted contract.¹⁴

(c) In a multi-state transaction in which the contractually chosen law is not within the competence of the opinion giver, it could opine as if enforceability were

⁹ See § III.B below.

¹⁰ A third-party opinion "should be sought by the opinion recipient only when the opinion's benefits justify its costs." *ABA Guidelines* § 2.2.

¹¹ This possibility is expressly noted in the *ABA Guidelines* at § 1.2, n.7.

¹² See *RESTATEMENT* § 95; *infra* text accompanying note 27.

¹³ See discussion *infra* Part IV.A.

¹⁴ See discussion *infra* Part IV.B.

determined under laws within the opinion giver's competence, or the opinion could be limited to enforceability in the opinion giver's jurisdiction of the choice of governing law provision.¹⁵

A decision among these choices should be made after engaging in the cost/benefit analysis described in this appendix.

II. THE COST/BENEFIT ANALYSIS

A. Other Benefits

As noted above, the principal benefit of a remedies opinion is to assist the opinion recipient in determining whether to enter into the transaction on specified terms. In doing the cost/benefit analysis, it is also necessary to identify other possible benefits to the opinion recipient.

(1) Discharge of Opinion Recipient's Responsibilities to Others. For example, parties like the agent in a syndicated loan transaction or the lead investor in a private placement of securities, where other parties are not represented by counsel, may feel there is an expectation that those parties will be provided with a remedies opinion from the borrower's or issuer's counsel.¹⁶

(2) Satisfying Statutory or Regulatory Requirements. For example:

(a) Banks regulated by the Comptroller of the Currency or Federal Reserve Board, or subject to the jurisdiction of the Federal Deposit Insurance Corporation, are obligated to employ safe and sound banking practices, and this is sometimes cited as the basis for requesting a third-party remedies opinion.¹⁷

(b) Regulations issued by the Department of Defense pursuant to authority granted in Title 41 of the United States Code contain a relevant condition to the effectiveness of a transfer by a government contractor of a procurement contract to a third party. This condition requires delivery to the Government of an opinion of legal counsel to each of the transferor and transferee which concludes that the transfer "was properly effected under applicable law."¹⁸

¹⁵ See discussion *infra* Part III.C.2.

¹⁶ Counsel for the agent or lead investor could of course give the same comfort without undertaking to represent the participant lenders or purchasers. However, counsel for agents and lead investors customarily do not give these opinions, possibly because of concerns about liability and in general the increased responsibility in the transaction. This appendix does not take the position that counsel for the agent or lead investor should give the opinion.

¹⁷ See, e.g., 12 U.S.C. § 1818(b)(1) (2004). The banking regulations do not, however, mandate that an opinion should be obtained, and bank examiners are generally more concerned with whether any condition to funding a loan established by a lender's approving body (e.g., a credit committee) that requires delivery of a legal opinion was in fact satisfied by the opinion obtained. Many banks request confirmation from their own counsel (whether in written form or orally) that the transaction documents comply with the conditions for funding the loan, and this confirmation, and the process followed by bank lawyers to provide the confirmation, seems to satisfy any "best practices" concerns that banks or other regulated institutions charged with operating in a "safe" manner may have.

¹⁸ 48 CFR § 42.1204(f)(5) (2004). The opinion required would not technically be a "remedies opinion" as it appears to focus more on process (e.g. "duly authorized, executed and delivered" opinion) than on validity or enforceability.

(c) Federal bank regulatory agencies require that banks obtain an opinion that any bilateral derivatives netting agreement is “enforceable” if the agreement is to be considered in calculating the bank’s capital.¹⁹

(d) The U.S. Maritime Administration (part of the Department of Transportation) requires an opinion of counsel for a shipowner seeking MARAD guarantees in Title XI financings that includes the essence of a remedies opinion.²⁰

(e) Section 314(b) of the Trust Indenture Act of 1939²¹ requires delivery to the Indenture Trustee of an opinion as to the “effectiveness of the lien”²² created by the indenture or other security documents which secure notes or debentures issued pursuant to an indenture registered under the Indenture Act, and delivery annually of an opinion that all action necessary to be taken to maintain such lien has been taken.

In situations like these, counsel to the party that seeks the benefit of the governmental program or is subject to the regulation is usually the logical one to deliver the opinion, as the opinion is primarily for its client’s benefit. The parties may shift the burden of giving the opinion, since the requirement to deliver a remedies opinion does not necessarily specify a third-party opinion, and the opinion could be given by counsel to any party in the transaction.

(3) “Benefit” of Estoppel

It has been suggested that one reason for obtaining a third-party remedies opinion is to raise an equitable estoppel against a later assertion by the opinion giver’s client that a particular undertaking is unenforceable. For example, a party may not be willing to enter into a financing transaction that has a complex or unusual structure, or a structure that is subject to potential recharacterization, unless there is an acceptable degree of assurance that all parties and their counsel agree about the legal consequences that flow from the structure and the remedies available assuming that the parties’ chosen structure is given legal effect.²³ In other transactions, one party may insist on a non-customary undertaking or a limitation of available remedies for breach, which are very important to that party’s commercial interest in the transaction.

However, it is doubtful that an estoppel could be asserted successfully against the opinion giver’s client based on its counsel’s third-party remedies opinion. The client usually is not bound by statements made by its counsel.²⁴ Even though a client has implicitly authorized an

¹⁹ 12 CFR Part 3, App. A, Sec. 3(b)(5)(ii)(B)(4).

²⁰ See DEP’T OF TRANSP. MAR. ADMIN., APPENDIX I TO GUARANTEE COMMITMENT, *available at* [http://www.MARAD.dot.gov/Title XI/US_flag/C_bondpu.pdf](http://www.MARAD.dot.gov/Title%20XI/US_flag/C_bondpu.pdf) (last visited July 15, 2004).

²¹ 15 USC § 77nnn(b).

²² While this statutory provision does not mandate an enforceability opinion, it is an example of an opinion “required” by statute, and the term “effectiveness” implies that the opinion giver at least concludes that the lien has been validly created.

²³ For example, a party may want assurance that a transaction structured as a lease will be given effect as such, and not as a secured financing, so that the lessor will have the benefit of lessor remedies. Ordinarily, absent an express opinion to such effect, a remedies opinion will not be interpreted to include a legal conclusion as to whether the transaction will be enforced as a “true lease,” or a “true sale.” *Cf.* N.Y. TriBar Comm., *Third Party Closing Opinions*, 53 BUS. LAW. 591 § 3.4.1 n.80 (1998) [hereinafter *1998 TriBar Report*].

²⁴ See RESTATEMENT § 28(3). While, under certain circumstances, a lawyer’s statement might be deemed an “admission,” the client would nonetheless be entitled to assert and prove that the statement is untrue. *Id.* §28(3) cmt. d.

opinion,²⁵ it is doubtful that the client will be deemed to have authorized an incorrect or misleading opinion. Accordingly, if the remedies opinion is erroneous, while the opinion giver may have responsibility, the giving of the opinion would not preclude the client from asserting that a clause or document is unenforceable.

Moreover, it is doubtful that any practical benefit would accrue to the opinion recipient from an attempt to assert an estoppel against the opinion giver in a later challenge. Even if the opinion giver is unable or unwilling to assert in litigation a position contrary to its remedies opinion, another lawyer for the opinion giver's client is under no such disability. Indeed, another lawyer might be ethically obligated to assert, if meritorious, that a provision is unenforceable, regardless of a contrary remedies opinion by the opinion giver.

Another "estoppel" argument is that the giving of a remedies opinion by an opinion giver is evidence that the subject contract was reviewed by the opinion giver and explained by it to its client. Hence, it is argued, the opinion giver's client is "estopped" from asserting that it did not understand the contract or provisions in question.

This argument too is weak because, as discussed above, the client is not estopped to assert a meritorious position because its counsel gave a remedies opinion. Moreover, this argument treats the opinion process as if it were designed to establish an evidentiary record, rather than a process that assists parties in their due diligence efforts incident to a transaction. To the extent an opinion recipient wants an evidentiary record, a more direct and cost effective way would be to obtain a representation from the opinion giver's client that it was represented by counsel who explained the relevant transaction documents to it.²⁶

Even if a third-party remedies opinion does not give rise to an estoppel, it can have an informal estoppel-like effect. For example, it can be used in subsequent negotiations related to the subject contracts. Thus, in a loan workout, for example, an earlier remedies opinion might be used in negotiations to counter an argument made by the opinion giver's client that a contract has legal infirmities. Accordingly, the estoppel benefit of a third-party remedies opinion should not be completely ignored.

B. Costs and Burdens

The key guiding principle for determining the appropriateness of a third-party remedies opinion is that the benefits derived must warrant the time and expense required to prepare the opinion.²⁷ The most obvious "cost" is additional fees of the opinion giver. This additional cost is difficult to justify if the opinion recipient's counsel separately addresses the same issues in a written opinion or otherwise as part of the representation of its client. Indeed, the opinion recipient's counsel may be in a better position to advise its client regarding the enforceability of contractual provisions if that counsel was the principal drafter of the contract or if the contract is generally in a form regularly used by counsel to the opinion recipient.²⁸

²⁵ See *Id.* § 21 cmt. e ("A lawyer has authority to take any lawful measure within the scope of representation that is reasonably calculated to advance a client's objectives. . ."); see also *ABA Guidelines* § 2.4.

²⁶ An example of such a provision is the following: "Each party to this Agreement represents and warrants to the other that it was represented by counsel who reviewed and explained this Agreement and related documents and the intended consequences in a manner satisfactory to such party."

²⁷ See *ABA Guidelines* § 1.2; discussion *supra* Part I.

²⁸ See *supra* text accompanying note 8; *infra* Parts II.C, III.D.

Perhaps of equal or greater importance than the economic cost, the negotiating process often results in significant delays in completing the transaction, and sometimes injects acrimony and distraction into the transaction as well.

Another potential non-economic “cost” is the possible intentional or inadvertent disclosure of a client’s negotiating strategy or confidential communications. For example, the opinion giver might identify an enforceability issue with respect to an undertaking proposed to be given by the opinion giver’s client in favor of the opinion recipient. After the opinion giver advises its client of the questionable enforceability, the client might decide not to address this undertaking at that point in the negotiation. Later, the client might agree to the questionable provision in exchange for a contractual concession by the opinion recipient. If the opinion giver is then requested to give a remedies opinion, ABA Guidelines contemplate that early disclosure will be made to the opinion recipient that the questionable provision may not be enforceable.²⁹ The result could be reopening of the negotiations.³⁰ In some cases, disclosure could constitute a violation of a lawyer’s ethical duties to the client and informed client consent to any such disclosure may well be required.³¹

Finally, some lawyers believe that the issuance of a third-party remedies opinion might give rise to a conflict of interest with the opinion giver’s client because the issuance of the opinion could result in an informal estoppel.³² Also, as discussed above, the opinion giver may be required to identify deficiencies and risks affecting the opinion recipient’s legal position that would not be in the opinion giver’s client’s interest to reveal, which produces a potential conflict between the opinion giver’s duties to its client and the responsibility of the opinion giver to the opinion recipient.³³

C. Reliance on Remedies Opinions

In many transactions, the opinion recipient may not, in fact, rely on the third-party remedies opinion in deciding to enter into the transaction. Usually, counsel for the opinion recipient has already considered and given advice to its client concerning the enforceability of contractual provisions in the transaction.³⁴ This is far more meaningful legal advice than the opinion recipient receives from a third-party remedies opinion, which is typically couched in legal conclusions without amplification. Where the attorney for the opinion recipient has advised its client of legal concerns about the documents, the opinion recipient will have difficulty successfully claiming reliance to the contrary on an erroneous opinion, since it has notice of the issues. Additionally, to the extent that the third-party remedies opinion has exceptions for particular provisions, the opinion recipient will not be able to claim reliance on the opinion when one or more of these excepted provisions turn out to be unenforceable. Moreover, inclusion of

²⁹ “Should a problem be identified that might prevent delivery of an opinion in the form discussed, the opinion giver should promptly alert counsel for the opinion recipient.” *ABA Guidelines* § 2.1.

³⁰ Conversely, often an opinion recipient will not want the opinion giver to identify enforceability issues with questionable provisions (for example, if the opinion recipient’s practice is to have all of its documents read uniformly and the questionable provision is enforceable in other jurisdictions) and will prefer that the scope of the opinion be narrowed or that the troublesome issue be excluded from the conclusions reached. *See 1998 TriBar Report* § 1.3, n.19; discussion *infra* Part II.C para. 2.

³¹ *See* MODEL RULES OF PROF’L CONDUCT, R. 2.3.

³² *See* discussion *supra* Part II.A.3.

³³ The opinion giver’s client could of course, on an informed basis, provide an effective waiver to any such conflict.

³⁴ RESTATEMENT § 20 cmt. e.

these exceptions may itself increase the risk that the subject provisions will be held unenforceable.

A principal duty of a lawyer representing a client in documenting a business transaction is to optimize the content of the documents for the client's benefit, consistent with the understandings and intentions of the parties. An opinion recipient could be benefited by the inclusion of provisions of questionable enforceability because other parties to the contract may comply with them regardless of enforceability.³⁵ Moreover, judicial receptivity to a questionable undertaking may change over time or from jurisdiction to jurisdiction. It is also not unusual for a client to be willing to enter into a transaction even if particular provisions, which are not deemed material, or even "essential," by the client, are wholly unenforceable. Accordingly, unless the validity or enforceability of the contract as a whole is in question, the opinion recipient's decision to enter into the transaction may not be impacted by the absence of a remedies opinion regarding these provisions, as the opinion recipient may want to retain the suspect provisions, regardless of enforceability. Obviously, where the issue of enforceability goes to the contract as a whole, e.g., because of a lack of consideration, it is doubtful a remedies opinion will be given. In that case, the parties may modify the agreement after consultation with their own lawyers to solve the enforceability problem. In this type of situation, the opinion recipient may rely in part on a third-party remedies opinion as an expression of the opinion giver's concurrence with the conclusion that the entire agreement is enforceable. But the opinion recipient's reliance is primarily on its own counsel's advice that a solution has been found.

It should be noted that even if there is limited reliance on the conclusions reached in a remedies opinion, opinion recipients can benefit from the process of analysis that precedes the issuance of the opinion. A request for the remedies opinion can serve the purpose of surfacing previously unrecognized unenforceable provisions. If no issues are raised by the opinion giver, some comfort is provided to the opinion recipient that no such unrecognized problematic provisions are contained in the document.

III. SPECIAL FACTORS

The "cost/benefit" analysis done in connection with a transaction to determine whether a third-party remedies opinion should be requested may be affected in some transactions by the presence of special factors.

A. Multi-Party Transactions

Sometimes a third-party remedies opinion is primarily for the benefit of a person that is not a party to the contract involved but is directly affected by it. The regulation promulgated by the Department of Defense cited above³⁶ provides an apt example. The regulation deals with the assignment by one party to another of a contract to which the United States Government is a party. The Government is not a party to the assignment transaction but is affected by it and requires a legal opinion that the assignment is valid. In a similar context, a licensor of a patent or trademark may require an opinion from counsel to the assignee that the assumption provisions of the assignment document are enforceable against the assignee, so that the licensor can enforce the license directly against the assignee.

³⁵ See *supra* note 30.

³⁶ See *supra* note 18.

In a project finance transaction, the enforceability of a third party's undertaking to pay money to the issuer of a debt obligation is one of the key elements in evaluating whether the issuer has the ability to pay the debt instrument. Underwriters and ultimate purchasers of highly rated debt securities often rely on undertakings by a liquidity enhancer to pay the debt upon default, or to purchase or remarket short-term debt that is tendered for repurchase. A remedies opinion relating to the undertakings of these liquidity enhancers is typically given.

Many multi-party transactions involve interdependent contractual arrangements. A lender financing the acquisition of another business by its borrower will usually want comfort that the undertaking by the seller to indemnify the buyer (the borrower) is enforceable. The lender may want to have the buyer to enforce the buyer's claims against the seller in case, for example, undisclosed liabilities impair the creditworthiness of the borrower. A purchaser of a business may want an enforceability opinion on an important supply contract between the business and a customer in which the customer agrees to purchase goods from the business. An investor in a business may require comfort that a previously obtained release of claims against the business by a third party or the grant of exclusive rights to exploit key technology is enforceable.

In these and many similar situations, counsel for the opinion recipient is not the most appropriate party to give the remedies opinion, because that counsel typically did not participate in the preparation or negotiation of the underlying contracts covered by the opinion.

B. Opinions to Unrepresented Parties

The foregoing analysis of whether a third-party remedies opinion should be given assumes that all parties to the transaction have the benefit of counsel. The question is which counsel is better able to provide the legal advice requested, or can do so in the most cost effective manner. In many transactions, however, some parties are not represented.

Rating agencies very frequently require remedies opinions concerning material documents that support the credit being rated, for example, the indenture and the key contracts that provide credit or liquidity enhancement. The rating agency assumes in its credit analysis that the parties will perform a contract, and a remedies opinion from counsel to an obligor provides support for the reasonableness of that assumption. Purchasers of securities from an issuer are often not represented by counsel, but might be entitled to rely on the issuer's counsel's opinion filed with the Securities and Exchange Commission as an exhibit to a registration statement.³⁷ As mentioned above,³⁸ participants in syndicated loans and investors in private placement transactions often are unrepresented. In these situations the third-party remedies opinion usually does not result in excessive costs; indeed, it tends to minimize the need for opinion recipients to obtain separate counsel.

³⁷ This so-called "Exhibit 5 Opinion" is addressed by counsel to the issuer, and concludes, with respect to debt securities, that they will be "legally issued and binding obligations" of the issuer. With respect to equity securities, it states that the shares have been legally issued and will be fully paid and non-assessable. Note that these opinions are not *third-party* opinions, and, because they do not deal with the enforceability of covenants or undertakings, may not be remedies opinions. See *1998 TriBar Report* § 3.1.

³⁸ See discussion *supra* Part II.A.1.

C. Specialized Legal Issues

1. Regulated Obligors

In some situations, the enforceability of a contract may depend on compliance with a regulatory scheme that applies to a party to the contract. For example, a standby securities purchase commitment undertaken by a corporation may not raise enforceability issues as a matter of contract law. If the commitment relates to shares of another entity and the undertaking is given by a regulated entity (for example, a bank, an insurance company, a public utility, or a governmental authority), additional issues may be raised under applicable regulations. A third-party remedies opinion given by counsel for the obligor is generally understood to include the conclusion that the undertaking is enforceable against the obligor under the applicable regulatory framework,³⁹ and, usually, the obligor's counsel is best suited to give an opinion that considers the effect of the regulatory elements in coming to the conclusions contained in the remedies opinion.⁴⁰ But the remedies opinion is not customarily interpreted to cover regulatory requirements applicable to the opinion recipient,⁴¹ and opinion givers assume (often explicitly, but sometimes implicitly)⁴² that the opinion recipient has full legal and corporate authority to enter into the transaction.

2. Counsel from Different Jurisdiction

Counsel for the parties are not equally capable of giving a remedies opinion where the opinion covers a contract that is governed by laws on which only one counsel is competent to opine. For example, when a party and its counsel are based in a state different from that of the other party and its counsel, the contract is often governed by the laws of one of those jurisdictions.

Because state laws are often different, it is sensible for the party that is unfamiliar with the chosen law to request a remedies opinion from the counsel that is familiar with it. It is often inefficient and costly to request the party whose counsel is not familiar with the chosen law to retain local counsel solely to give a remedies opinion to a party whose counsel is familiar with the chosen law.⁴³ In situations where neither party's counsel is familiar with the law chosen by the contract and local counsel is retained, it may be wiser for the opinion recipient to seek to have local counsel represent it and provide the opinion recipient with local law advice directly, even where the fees of such local counsel are to be borne by the other party. Local counsel retained by the opinion recipient will be far more likely to provide advice to the opinion recipient on all relevant matters arising under the chosen law, not just uncertainties in the enforceability of contract provisions under the selected law.

³⁹ See *1998 TriBar Report* § 3.5.2(a)(i).

⁴⁰ It is of course possible to bifurcate the enforceability opinion in this situation and to deal separately with enforceability of the contract under laws having specific application to the obligor. This is often covered by an opinion that the performance of the agreement will not violate any statute, rule or regulation having applicability to the obligor.

⁴¹ See *1998 TriBar Report* § 3.5.2(a)(ii).

⁴² "Similarly, in giving a remedies opinion, the opinion preparers will usually assume that the agreement is binding on the other parties to it." *1998 TriBar Report* § 2.3(a).

⁴³ See *ABA Guidelines* § 2.2. It may be prudent, however, for counsel not familiar with the chosen law to recommend engaging counsel to advise its client regarding that law, even if no remedies opinion is given, in order to obtain advice on potential legal pitfalls.

Where the parties have agreed not to retain local counsel, counsel that does not regularly opine on the chosen law is sometimes asked to provide a remedies opinion assuming that enforceability of the contract would be determined under the law of the opinion giver's jurisdiction rather than the law chosen by the contract.⁴⁴ Alternatively, the opinion giver may be requested to limit its enforceability opinion solely to the question of enforceability in the opinion giver's jurisdiction of the choice of law provision.⁴⁵ Each of these approaches (whether together or as alternatives) seems to be sensible and to promote efficiency in appropriate cases.

D. Regularly Used Documents

Frequently, a third-party remedies opinion is requested on documents that are prepared and regularly used by the requesting party or its counsel, and are basically in the same form from one transaction to the next. Lenders, in particular, frequently insist on standardized agreements, as this makes for more efficient administration of loans. The benefit of this remedies opinion to the opinion recipient is doubtful. It appears to be both more beneficial and cost effective for the opinion recipient to rely on its own counsel for legal advice regarding enforceability. Therefore, a request for a remedies opinion, in this situation, in the absence of special factors in the transaction, seems inappropriate.⁴⁶

IV. LIMITED SCOPE OPINIONS

A. Ancillary vs. Principal Documents

In analyzing the cost of preparing the remedies opinion against the benefits provided by its receipt, the relative weightings will obviously not be the same in each transaction. In addition, the weights assigned will not even be the same for all documents in the same transaction. For example, some documents in a transaction may be simple and contain few undertakings. Others may merely be shorter forms of more complete agreements, used, for example, solely for filing purposes (e.g. copyright mortgages, patent security agreements, or memoranda of leases). Some (for example, environmental indemnities and an agreement among shareholders restricting stock transfers) may be short and ancillary but nonetheless raise significant issues that could result in additional qualifications in the remedies opinion, or require significant legal analysis because of the need to weigh many different factors. These documents are typically ancillary documents, which, while playing a role in the transaction, do not contain the principal contractual undertakings that have induced the parties to enter into the deal. Where this is the case, a request for a remedies opinion concerning these ancillary documents may provide little benefit, but on the other hand may require significant cost to analyze.⁴⁷ While it is difficult to draw general and clear lines, counsel and their clients should be particularly mindful of the cost/benefit analysis in requesting remedies opinions on ancillary documents.

⁴⁴ This approach sometimes is implemented by inclusion of an assumption that the law of the jurisdiction selected by the contract is the same as that of the opinion giver's jurisdiction. While this assumption is probably incorrect (and therefore the approach discussed in the text is preferred), this approach is common, and if utilized, would not be misleading.

⁴⁵ See 1998 TriBar Report § 4.6.

⁴⁶ A large number of members of the Opinions Committee are of the view that a request for a remedies opinion in this situation "is" inappropriate, although the Committee believes that customary practice should determine the appropriateness of the request.

⁴⁷ See 1989 Report § IV.B.1 ("[t]he lawyer . . . should resist acquiescing to provisions [in the Opinion] which, while having some importance to the recipient, are peripheral to the transaction covered by the agreement at hand.")

B. Complex Documents

Frequently, documentation in a transaction includes numerous and varied contractual undertakings. These undertakings may be in a single principal document, a number of separate documents, or combined from various documents into the text of a single master or omnibus agreement. For example, acquisition agreements not only include an agreement to purchase and sell, but will often also include undertakings about such matters as the parties' pre-closing conduct, post-closing treatment of employees, preparation and filing of tax returns, accounting matters, collection of accounts receivable, post-closing non-competition, non-solicitation and non-disclosure, indemnification obligations, and the consideration to be paid by the buyer. If there are enforceability issues with undertakings in complex documents, they may arise under a wide variety of legal regimes, including, for example, laws relating to general corporation matters, securities regulation, employment, antitrust, tax, intellectual property, environmental and real estate law. While a remedies opinion is generally understood not to cover some of these specialized areas,⁴⁸ many of these substantive laws are understood to be covered.⁴⁹ In situations involving complex documentation or wide-ranging subject matter, the cost/benefit analysis might lead the parties to conclude that a limitation on the scope of the opinion to specific undertakings is appropriate.

V. CONCLUSIONS

A request for a third-party remedies opinion should only be made when the benefit to be obtained by the opinion recipient justifies the cost of its preparation, and where there is no alternative that is more cost effective.⁵⁰ The cost/benefit analysis involves measuring the cost of preparation against the benefit that the opinion recipient obtains through its reliance on the remedies opinion, taking into account the size and complexity of the transaction. It is not an anomaly that remedies opinions are regularly requested and given in many large transactions, regardless of the nature of these transactions.⁵¹ The customary practice of providing third-party remedies opinions in these transactions is recognition that even a small incremental benefit can justify significant costs where large sums of money are at stake.

Third-party remedies opinions are also clearly beneficial in many situations, regardless of the size of the transaction, as discussed in Section III above.

In the absence of special factors, the benefit to be obtained by an opinion recipient from a third-party remedies opinion can often be realized in a more cost-efficient and informative manner through advice provided by the opinion recipient's own counsel, especially as it relates to documents regularly prepared by counsel to the opinion recipient for the opinion recipient. In

⁴⁸ See 1998 *TriBar Report* § 3.5.2(c); *infra* App. 10, Part IV.B.2.

⁴⁹ For example, usury issues and certain securities matters are considered part of a remedies opinion. See 1998 *TriBar Report* § 3.5.2(c). In addition, corporation, employment and intellectual property laws are generally understood to be included in a remedies opinion. "Customary practice requires the opinion preparers to take account of law that lawyers who render legal opinions of the type involved would reasonably recognize as being applicable (i) to transactions of the type covered by the agreement and (ii) to the role of the [opinion giver's client]. . . in the transaction." *Id.* 3.5.1..

⁵⁰ ABA *Guidelines* § 1.2.

⁵¹ See *supra* note 4.

general, it would seem inappropriate for a third-party remedies opinion to be requested or given in that circumstance.

While clients are usually the ultimate decision-makers about whether to request a third-party remedies opinion in a transaction, their lawyers should assist them with an appropriate cost/benefit analysis.

APPENDIX 5

CUSTOMARY OPINION PRACTICE

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APPENDIX 5 CUSTOMARY OPINION PRACTICE

I. INTRODUCTION

Customary practice has become a unifying tenet of recent literature discussing third-party legal opinions.¹ Since no other alternative general standard or approach to third-party opinion practice has attained general acceptance or wide use,² opinion givers and lawyers representing opinion recipients should seek to come to a common understanding of applicable customary opinion practice.

The California Business Law Section of the California State Bar recognizes and supports the movement toward a uniform national customary practice for remedies opinions in light of the volume of interstate business and financing transactions in which opinions are rendered.³ California lawyers can find guidance on customary opinion practice in Bar Association reports and other literature published in California and elsewhere.⁴

II. DUAL ASPECTS OF CUSTOMARY PRACTICE

Customary practice provides a *general guide for conduct* among lawyers and clients giving, receiving and interpreting opinions. It also provides a standard for determining whether the *legal duty of care* owed by the opinion giver to the recipient has been met.⁵

According to the Restatement, an opinion giver owes a duty of care to the opinion recipient, just as it does to its own client.⁶ The components of the duty of care are *competence*

¹ See The Am. Bar Ass'n. Comm. on Legal Opinions, *Legal Opinion Principles*, 53 BUS. LAW. 831, § I B (1998) [hereinafter *ABA Principles*]; TriBar Opinion Comm., *Third Party "Closing" Opinions*, 53 Bus. Law 591 §§ 1.1, 1.4 (1998) [hereinafter *1998 TriBar Report*]; see also Bus. Law Section of the State Bar of Cal., *Report on Third-Party Remedies Opinions* § V (2004), to which this appendix is attached [hereinafter *Umbrella Report*] and *infra* App.8 (discussion of customary practice as an important basis for resolving perceived historic disagreements between the "California" view and the "New York" view regarding the scope and meaning of remedies opinions).

² The most common alternative approach, incorporating by reference a set of mutually agreed standards, was advocated by the Am. Bar Ass'n Section of Business Law, *Third-Party Legal Opinion Report, Including the Legal Opinion Accord*, 47 Bus. Law 167 (1991) [hereinafter *Accord Report*], but the Accord never achieved general acceptance or wide use. *ABA Principles* 831. See Bus. Law Section of the State Bar of Cal., *Statement of the Business Law Section of the State Bar of California January 2001*, *supra* App. 3 n. 4 [hereinafter *2001 Statement*]. See also *infra* § IV C (discussing "reasonableness in the circumstances" as a standard).

³ *2001 Statement* 2; *infra* App.8 § VI. See RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 95 cmt. a (2000) [hereinafter *RESTATEMENT*].

⁴ See *infra* § V B; *2001 Statement*. See generally Restatement § 95 cmts. b, c; Donald W. Glazer, Scott FitzGibbon & Steven O. Weise, *Glazer and FitzGibbon on Legal Opinions: Drafting, Interpreting and Supporting Closing Opinions in Business Transactions* § 1.6.1 (2d ed. 200) [hereinafter *GLAZER, FITZGIBBON & WEISE*].

⁵ See *1998 TriBar Report* § 1.4(a); *RESTATEMENT* § 95 cmt. c. See also Section V of the *Umbrella Report* and *infra* App. 8.

⁶ *RESTATEMENT* §§ 51(2) & cmt. e ("When a lawyer or that lawyer's client (with the lawyer's acquiescence) invites a nonclient to rely on the lawyer's opinion . . . and the nonclient reasonably does so, the lawyer owes a duty to the nonclient to use care . . . , unless the jurisdiction's general tort law excludes liability on the grounds of remoteness. Accordingly, the nonclient has a claim against the lawyer if the lawyer's negligence with respect to the opinion . . . causes injury to the nonclient."), 95(1), 95(3). See also *infra* App. 8, and accompanying text (no California cases discovered specifically addressing the duty of care by an opinion giver to an opinion recipient).

and *diligence*.⁷ The duty is measured by the competence and diligence normally exercised by lawyers in similar circumstances,⁸ which is primarily customary practice.

III. OPINION LITERATURE AND THE MEANING OF CUSTOMARY PRACTICE

In the last several years, Bar Association reports and other opinion literature published outside California have identified and emphasized the central role played by customary practice (sometimes “custom and practice”⁹) in giving, receiving and interpreting opinion letters.¹⁰ Customary practice is in fact the “starting point” for what an opinion giver should consider when giving a legal opinion. Absent an agreement to the contrary or other mitigating circumstances, an opinion recipient is entitled to assume that the opinion giver has followed customary practice in giving an opinion, and an opinion giver is entitled to assume that the opinion recipient understands customary practice.¹¹ In this context, customary practice includes both “*customary diligence*” (the factual and legal investigation an opinion giver undertakes to support a particular opinion) and “*customary usage*” (how words are used in opinion letters).¹²

The use of customary practice by lawyers similarly situated as a key standard for *diligence* in preparing legal opinions seems relatively free of controversy.¹³ It may be less self-evident that customary practice is a key standard for the *interpretation* of opinions.¹⁴ Nonetheless, it is clear that certain words and phrases are, by custom, understood to have special meanings in the context of specific legal opinions.¹⁵ For example, most would agree that various formulations of “legal, valid, binding and enforceable” in remedies opinions are by custom understood to be equivalent to the single concept “enforceable.”¹⁶ Discussion about whether the

⁷ RESTATEMENT § 52(1) & cmts. b (competence), c (diligence); see MODEL RULES OF PROF’L CONDUCT R. 1.1 (competence), 1.3 (diligence); CAL. RULES OF PROF’L CONDUCT R. 3–11 (competence and diligence); *infra* App. 8 § III A 2. While potentially relevant evidence, the violation of a professional conduct rule in and of itself “should not give rise to a cause of action nor should it create any presumption that a legal duty has been breached.” Am. Bar Ass’n, MODEL RULES OF PROF’L CONDUCT, Introductory Scope (1983); see RESTATEMENT § 52 cmt. f & reporter’s note

⁸ See *infra* § IV B; App. 8 § III.

⁹ See RESTATEMENT, *supra* note 4, § 95 & cmt. a.

¹⁰ See, e.g., The Am. Bar Ass’n. Comm. on Legal Opinions, *Report: Guidelines for the Preparation of Closing Opinions*, 57 BUS. LAW. 875 (2002) [hereinafter *ABA Guidelines*]; *ABA Principles* at 831; 1998 *TriBar Report* § 1.4; RESTATEMENT § 95 reporter’s notes to cmts. b, c; GLAZER, FITZGIBBON & WEISE § 1.61.

¹¹ *ABA Guidelines* § 1.7; 1998 *TriBar Report* § 1.4(a).

¹² 1998 *TriBar Report* § 1.4. See also *infra* note 15 and accompanying text; App. 8 § III A 2.

An opinion giver may vary customary meaning or customary diligence by including an express statement in the opinion letter to that effect or by reaching an express agreement with the opinion recipient. *ABA Principles* § I C. Customary practice bears on opinion practice in other important ways, including determining the scope of the opinion requested, e.g., the matters and the law covered by the opinion (See *ABA Principles* § II B; 1998 *TriBar Report* § 3.5.1; see generally *ABA Guidelines*; GLAZER FITZGIBBON & WEISE at 257), and the competence expected of the opinion giver (see *infra* note 18 and accompanying text; App. 8 § III C).

¹³ See, e.g., RESTATEMENT §§ 95 cmt. e (“[O]nce the form of opinion has been agreed on, customary practice will also determine the nature and extent of the factual and legal diligence to be employed by the opinion giver in connection with its issuance.”), 52 cmt. c; 1998 *TriBar Report* § 1.4(c).

¹⁴ See 1998 *TriBar Report* § 1.4(b).

¹⁵ See 1998 *TriBar Report* § 3.1.

¹⁶ See *Accord Report*, Commentary ¶ 10.1; Comm. on Corporations of the Bus. Law Section of the State Bar of California, 1989 *Report of the Committee on Corporations Regarding Legal Opinions in Business Transactions*, 45 Bus. Law. 2169, § V C (1990), , reprinted in Bus. Law Section & Real Property Section, State Bar of California,

remedies opinion covers “each and every undertaking” or only “essential provisions” centers on the meaning of words that are generally the same in all remedies opinions and about what lawyers and their clients understand the words to mean.¹⁷

Customary practice has additional application to closing opinions beyond customary usage and customary diligence, most notably in determining “*customary competence*”. In the context of a remedies opinion, competence connotes a level of knowledge, understanding and skill of the opinion giver in applying (i) substantive law to recognize legal issues raised by the documentation opined on *and* (ii) principles and practices relating to the process of preparing the remedies opinion.¹⁸

In its 2001 Statement, the California Business Law Section, after citing prior opinion reports published by the Section and drawing practitioners’ attention to other sources (including the Restatement, the ABA Guidelines, the ABA Principles, and the 1998 TriBar Report), concurred that “customary practice is and should be a very important guiding consideration for both opinion givers and opinion recipients,” in giving, receiving and interpreting third-party legal opinions.¹⁹ The 2001 Statement declares that, although local practices have differed in the past in certain respects and may continue to differ, certain opinion reports published outside California provide a helpful description of customary practice as understood and followed by a large segment of U.S. practitioners.²⁰

IV. SOME UNCERTAINTIES ARISING FROM THE USE OF CUSTOMARY PRACTICE

Customary practice is of course based on what lawyers actually mean in using certain words and do in third-party opinions practice. Not surprisingly, customary practice can in certain instances be difficult to ascertain. For this and other reasons, application of customary practice has its uncertainties.

A. Customary Practice Where?

One area of uncertainty arises out of the possibility that customary opinion practice may differ in various geographical locations, as recognized by both the 2001 Statement²¹ and the Restatement.²² As a result, lawyers from different jurisdictions in a transaction may not

California Opinion Reports (2002) [hereinafter *1989 Report*]; *1998 TriBar Report* §§ 1.4(b), 3.1. As of September 2004, the Corporations Committee of the Section is preparing a report that revises and restates the *1989 Report*.

¹⁷ California lawyers do not tend to use wording for the basic remedies opinion that differs significantly from that used elsewhere. Arguments for the “each and every” or “essential provisions” interpretation are not dependent on different wording, but rather are based on different understandings of the same words. The dispute may be thought of as a question of different views of the “customary usage” of those words. Appendix 8 concludes that the outcome of that discussion has little practical relevance, since the exercise of customary diligence and customary competence do not vary significantly among opinion givers that regularly give remedies opinions. See *Umbrella Report* § V; *infra* App. 8 § VI; *infra* note 36 and accompanying text; note 37.

¹⁸ See *infra* App. 8 § III C.

¹⁹ *2001 Statement* at 3.

²⁰ *Id.* See *1998 TriBar Report* § 1.4; RESTATEMENT § 52 reporter’s notes to cmts. b, c.

²¹ *2001 Statement* at 3.

²² RESTATEMENT § 52 cmt. b (discussing competence).

understand in the same way, for example, the meaning of or diligence or competence required for an opinion letter. This is a problem in a world of increasing numbers of interstate transactions, but it is a problem that as a practical matter is being ameliorated by the evolution toward national uniformity of business law and opinions practice.

B. Customary Practice by Whom?

Moreover, it is often difficult to apply descriptions in opinion literature of the lawyers whose practices are referred to in determining customary practice. Those descriptions are general and are not entirely consistent. The Restatement states that a lawyer who owes a duty of care “must exercise the *competence* and *diligence* normally exercised by lawyers *in similar circumstances*.”²³ The professional community whose practices and standards are relevant is ordinarily that of *lawyers undertaking similar matters in the relevant jurisdiction*.²⁴

Importantly, in the context of giving opinions and advising opinion recipients, the ABA Principles state that matters addressed in closing opinions, the meaning of the language normally used, and the scope and nature of the work counsel is expected to perform are based on the customary practice of lawyers *who regularly give, and lawyers who regularly advise opinion recipients regarding, opinions of the kind involved*.²⁵ Other sources use different formulations.²⁶ While there is little in opinion literature that provides further help in identifying these lawyers in

The Accord seems to assume that the appropriate measuring location is the “Opining Jurisdiction.” *Accord Report*, Accord §§ 10 and 18. The Restatement favors a wider, perhaps national, geographical measure, at least in addressing competence. RESTATEMENT § 52 cmt. b (“The professional community whose practices and standards are relevant in applying this duty of competence is ordinarily that of lawyers undertaking similar matters in the relevant jurisdiction (typically, a state). . . . The locality test is now generally rejected for all professions, because all professionals can normally obtain access to standard information and facilities, [and] because clients no longer limit themselves to local professionals”).

²³ RESTATEMENT § 52 (1). Italics are added in the text and footnotes throughout this heading.

²⁴ RESTATEMENT § 52 cmt. b (discussing competence). Comment b also describes the duty of competence as *the skill and knowledge normally possessed by members of that profession in good standing*, citing RESTATEMENT (SECOND) TORTS §299A (1976). See *supra* § IV A (discussing the relevant jurisdiction).

²⁵ *ABA Principles* § I.B.

²⁶ Compare Accord § 10 relating to the law that is covered by a remedies opinion (“the law of contracts . . . and other laws of the Opining Jurisdiction that a lawyer in the Opining Jurisdiction exercising customary professional diligence would reasonably recognize to be directly applicable to the Client, the Transaction, or both.”) with Accord § 18 relating to the inclusion of an implied opinion (“if it is both essential to the legal conclusion reached by the express opinion and, *based upon prevailing norms and expectations among experienced lawyers in the Opining Jurisdiction*, reasonable in the circumstances.”).

The California 1989 Report initially recites a general standard for lawyers, as “*such skill, prudence and diligence as lawyers of ordinary skill and capacity possess and exercise in the performance of the tasks which they undertake*,” quoting *Lucas v. Hamm*, 56 Cal.2d 583 (1961). 1989 Report § III. However, the 1989 Report then sets forth a very high legal diligence requirement: “. . . to discover those additional rules of law which, although not commonly known, may readily be found by standard research techniques,” based on language in *Smith v. Lewis*, 13 Cal.3d 349 (1975) (a case not involving a legal opinion, but rather a malpractice claim by a client against the client’s own lawyer in a divorce case). 1989 § III. Some have expressed concern that that the 1989 Report may be read to impose this high legal diligence duty on opinion givers. See *infra* App. 8 § III 2 (discussing the legal diligence issue, and concluding that this interpretation is incorrect). The 1989 Report separately notes that where a legal matter falls within a recognized specialty a lawyer may have a duty to refer the client to a specialist, and the duty of care may be measured by a specialist in similar circumstances. 1989 Report § III.

the context of remedies opinions, it would be prudent for opinion givers to assume that courts will apply a standard of customary practice as exercised by lawyers *who regularly give opinion letters of the same type in similar types of transactions*.²⁷

C. Customary Practice and Reasonableness in the Circumstances.

Finally, notwithstanding its prevalence in recent opinion literature, there remains a lingering question as to the extent to which customary practice is a standard at all. Without specific reference to opinion practice, slavish and exclusive adherence to a customary practice standard bears the inherent risk of endorsing and entrenching practices of lawyers that should be changed. In some instances, the Restatement reverts to a general description of the duty of care that seems to supplement the general standard of “*competence and diligence normally exercised by lawyers in similar circumstances*” (customary practice) with the idea of “*reasonable in the circumstances*.”²⁸ For example, the duty of diligence requires that a lawyer devote reasonable diligence, including performing “tasks reasonably appropriate to the representation, including where appropriate, inquiry into facts, analysis of law, exercise of professional judgment, communication with the client, rendering of practical and ethical advice, and drafting of documents.”²⁹ At base, the problem is one of trying to apply abstract word descriptions to concrete, practical professional life. It is clear that the duty of care in general ties to customary practice, that which other lawyers exercise in a similar situation. However, lawyers should become uneasy when customary practice seems to lead to an unreasonable result.

V. WHO DETERMINES CUSTOMARY PRACTICE?

Ultimately, the utility of customary practice as a standard in a particular transaction is determined by whether the opinion giver, on the one hand, and the opinion recipient and its counsel, on the other, understand customary practice the same way.³⁰ When in doubt, where can lawyers go to find out what customary practice is?

A. Experience and Agreement by Lawyers in the Transaction.

The best source is the practice experience of the lawyers in the transaction or of the firms in which they practice.³¹ If they recognize that they may not understand customary opinion practice in the same way, the lawyers should seek to reach agreement about what customary practice is, or otherwise agree about the diligence for and meaning of the closing opinion in the transaction. However, discussing all aspects of customary practice is not practical in most transactions. Moreover, agreement by the lawyers in the transaction may not be dispositive, as

²⁷ Whatever standard is used, it is likely that a finder of fact would rely on expert testimony concerning the duty of care and the opinion giver’s success or failure in exercising that care. RESTATEMENT § 52 cmt. g.

²⁸ Compare the following two statements in comment b to Restatement § 52 (discussing competence): “As is generally true for professions, the legal duty refers to normal professional practice to define the ordinary standard of care for lawyers, rather than referring to that standard as evidence of reasonableness.” “The duty is one of reasonableness in the circumstances.”

²⁹ RESTATEMENT § 52 cmt. c.

³⁰ See RESTATEMENT § 95 reporter’s note to cmt. c.

³¹ In a particular firm, this practice experience may be shared horizontally among lawyers practicing in the same or different areas of the law, or vertically, passed down by lawyers with broad experience gained over years of practice.

others may have an interest.³² In any event, if the lawyers do not agree, they should consider consulting other resources.³³

B. Bar Association Reports and Other Literature.

A primary source for external information on customary opinion practice is Bar Association reports and other opinion literature.³⁴

Although many non-California reports state that they *describe customary practice*, often they also are *prescriptive as to what customary practice should be*. These reports tend to say that customary practice is what the sponsoring committee members and drafters say it is or should be.³⁵ Since those preparing these reports are experienced practitioners well known in the fields of business law and opinion practice, their pronouncements are influential on customary practice, whether or not they are entirely reportorial.

A difficulty arises in the unusual circumstance where inconsistent answers are provided by different opinion reports. One such issue is an historic disagreement between the “California” view that a remedies opinion addresses the enforceability of only the “essential provisions” of a contract and the “New York” view that the opinion addresses “each and every undertaking”, as discussed in Section V of the Umbrella Report and in Appendix 8.³⁶ Fortunately, such inconsistencies are rare.

The Umbrella Report and its appendices are largely an effort to report on the customary practice of California lawyers. Nonetheless, readers may occasionally find some of the same tension between reporting and prescribing.

³² *E.g.*, clients may engage other counsel or an opinion letter may appropriately be relied on by someone not at the table. *See generally Umbrella Report* § III; *supra* App. 4 § III.

³³ As mentioned *supra*, note 12, an opinion giver may, absent an express understanding with the opinion recipient or its counsel, vary or disclaim the customary meaning of an opinion or the scope or nature of the diligence customarily required to support an opinion by including an express statement to that effect in the opinion letter. The opinion recipient, of course, may not agree to accept an opinion that contains such an express statement.

³⁴ *See supra* note 1. The Restatement recognizes Bar Association reports as resources for understanding third party legal opinions, particularly citing various Tribar Committee reports and the ABA Principles. RESTATEMENT § 95 reporter’s notes to cmts. b, c. It notes that most reports state that they mainly declaratory of existing custom and practice, and contribute to uniformity of practice among lawyers issuing legal opinions.

While previous opinion reports published by the California Business Law Section largely avoided expressly identifying or describing customary practice, they nonetheless provide a useful source of information about what the experienced lawyers who drafted the reports thought (for example, the 1989 Report makes little express reference to customary practice; rather it usually describes normative guidelines for important aspects of opinion practice, including diligence and coverage). By contrast, the 1998 Tribar Report expressly provides guidance on customary practice in giving closing opinions. 1998 *TriBar Report* §§ 1.1, 1.4(a). Likewise, the ABA Guidelines directly addresses developments in customary practice, and the ABA Principles are intended to be a ready reference to selected aspects of customary practice. *See, e.g., ABA Principles* §§ I.B, II.B, II.D, III.A and III.B.

³⁵ *See, e.g., ABA Guidelines* § 4 (setting forth prescriptive standards for specific opinions, including foreign qualification and good standing, legal and contractual compliance and negative assurances). This may be appropriate if it is not clear what customary practice is, or if there is a feeling that customary practice should be changed, so long as the reports are clear about what they are doing.

³⁶ *See also 2001 Statement* at 3. *See generally 1998 TriBar Report* note 69; GLAZER, FITZGIBBON & WEISE § 9.7.

VI. SURVEYS

Surveys of lawyers can help to determine what customary practice is, as well as providing other important useful information. As a practical matter, however, contemporaneous surveying is not available to lawyers in the middle of a transaction. Accordingly, published survey results are available only as general background. Still, as evidence of actual practice, the results of these surveys merit attention.

A. Complications.

Unfortunately, conducting a survey has its notable complications. For example:

- * Who performs the survey (who prepares and distributes the surveys, and who gathers, synthesizes and reports the survey results)?
- * Where should the survey be taken (what jurisdictional or geographic scope)?
- * Who should be surveyed (within the identified jurisdictional or geographic scope)?
- * How are the survey questions framed?
- * How long after completion are surveys useful?

It is difficult to obtain a satisfactory or even meaningful sample, especially as many lawyers are disinclined to respond to surveys, often due to a reluctance to commit the necessary time. Also, questions in surveys are not always clear, even after great effort to make them so, and answers are not always responsive.

B. Committee Surveys.

In an effort to gather information on various questions germane to, or illustrative of, customary practice, and to identify, address and attempt to resolve questions and issues presented in the Umbrella Report and its appendices, the California Opinions Committee conducted numerous informal surveys and inquiries among committee members and their firms and colleagues.

Importantly, in 2001 the Opinions Committee conducted a relatively structured informal survey of California law firms (both local and regional firms and the California-based offices of national and international firms) about certain aspects of their practices relating to remedies opinions. While subject to all of the complications mentioned above, the 2001 Survey provides very useful information about California customary practice in relation to the remedies opinion. Appendix 6 to the Umbrella Report is the form of the 2001 Survey, and Appendix 7 summarizes the survey results.³⁷

³⁷ The 2001 Survey produced ambiguous information on the issue of “each and every” vs. “essential provisions.” 34% of the law firms surveyed accept the “each and every” standard, and another 46% state that, although they have not accepted that standard, they feel they must act as if it applies to avoid undue exposure to liability on their opinions. *Infra* App. 7 § 7. *See supra* § V B; note 17.

VII. OTHER RESOURCES

Other external resources, such as legal treatises, law review articles and other publications, as well as continuing legal education and Bar Association conferences, forums and committee work, also are available to provide information on customary practice.

VIII. SUMMARY AND CONCLUSION

The California Business Law Section, in adopting the Umbrella Report, reaffirms the importance of customary practice in giving, receiving and interpreting third-party closing opinions, and the desirability of achieving, where practical, national consensus on customary practice. Bar Association reports and other opinions literature are important sources of information about customary practice. While the Opinion Report and its appendices are based in part on surveys and in general reflect the views of members of the Opinions Committee as to what opinion practitioners actually understand and do, they are occasionally prescriptive in the sense of presenting views as to what customary practice should be.

Lawyers should be realistic in recognizing that uncertainties exist about customary practice. In the real world, lawyers negotiating opinions should talk with each other about what they understand customary practice to be, particularly where there is doubt about whether they have a common understanding. Those who give or represent clients who receive remedies opinions in their practices are encouraged to read Bar Association reports and other relevant literature for assistance in determining customary practice.

APPENDIX 6

THIRD-PARTY LEGAL OPINION SURVEY

APPENDIX 6

THIRD-PARTY LEGAL OPINION SURVEY

Introduction

The California State Bar Business Law Section's Task Force on Legal Opinions is gathering information about customary practices in California concerning third-party legal (closing) opinions.

We do not plan to disclose individual responses outside the Task Force. However, the Task Force may disclose to others compilations of the survey results and participants.

If you have any questions about this survey, please contact Morris Hirsch at (415) 765-3874.

Please return your survey response (by regular mail, fax or e-mail) by **July 19, 2001**, to:

Morris Hirsch
400 California Street, 16th Floor
San Francisco, CA 94104
Fax: (415) 765-3391
E-mail: morris.hirsch@uboc.com

Thank you very much for your assistance.

Background Information

Name of person completing survey: _____

Phone number: (____) _____

Law firm: _____

Size of law firm:

- ___ a. up to 10 lawyers
- ___ b. 11 to 100 lawyers
- ___ c. more than 100 lawyers

Is your firm a multistate law firm?

- ___ a. Yes.
- ___ b. No.

Does your firm have an Opinion Committee (or a designated group of lawyers within your firm) that (1) sets firm policy for the delivery of legal opinions and/or (2) approves (or a member of which approves) a legal opinion before the firm delivers the opinion?

- ___ a. Yes.
- ___ b. No.

What is your current position in the firm? *(Check all that apply.)*

- ___ Partner
- ___ Associate
- ___ Chair of Opinion Committee
- ___ Member (but not Chair) of the Opinion Committee
- ___ Managing Partner of the firm
- ___ In-house General Counsel for the firm
- ___ In-house Ethics Counsel for the firm
- ___ Other. Please describe: _____
- _____

Survey

Unless otherwise indicated, all questions relate solely to your firm's customary practices when issuing third-party legal (closing) opinions under California law. This survey focuses on remedies opinions, as opposed to other types of legal opinions. Remedies opinions can be expressed in various ways, but essentially relate to the enforceability of one or more contracts.

1. In what types of transactions does your firm customarily issue remedies opinions (assuming any legal opinion is given in the transaction)?

- ___ a. Securities offerings
- ___ b. Mergers & acquisitions
- ___ c. Real estate sales
- ___ d. Loans, including loans:
 - ___ i. Secured by personal property
 - ___ ii. Secured by real estate
 - ___ iii. Unsecured
- ___ e. Lease transactions:
 - ___ i. Personal property
 - ___ ii. Real estate
- ___ f. Other types of transactions. Describe: _____
- _____
- _____

2. When giving a remedies opinion with respect to the enforceability of a contract, does your firm customarily consider the opinion to include:

- ___ a. Each and every provision of the contract.
- ___ b. Only the essential, material or some similar subset of the contract's provisions.
- ___ c. My firm believes 2.b is customary, but as a precaution we prepare remedies opinions as if 2.a were applicable.

3. Does your firm customarily include a "generic exception"* when it issues remedies opinions?

- ☐ a. Yes.
- ☐ b. No.
- ☐ c. Only in certain types of transactions. Describe: _____

* Specific forms of a "generic exception" vary, but here is an example:

Our opinion is subject to the qualification that certain provisions of the Agreement may be unenforceable, but such unenforceability will not, subject to the other exceptions, qualifications and limitations contained in this opinion letter, render the Agreement invalid as a whole or substantially interfere with realization of the principal benefits intended to be provided by the Agreement.

4. Please indicate which, if any, of the following types of contractual provisions your firm customarily expressly excludes from its remedies opinions:

- ☐ a. Choice-of-law provisions.
- ☐ b. Covenants not to compete.
- ☐ c. Provisions for penalties, liquidated damages, acceleration of future amounts due (other than principal) without appropriate discount to present value, late charges, prepayment charges, or increased interest rates upon default.
- ☐ d. Time-is-of-the-essence clauses.
- ☐ e. Confession of judgment clauses.
- ☐ f. Provisions that contain a waiver of broadly or vaguely stated rights.
- ☐ g. Provisions that contain a waiver of the benefits of statutory, regulatory, or constitutional rights, unless and to the extent the statute, regulation, or constitution explicitly allows waiver.
- ☐ h. Provisions that contain a waiver of unknown future defenses.
- ☐ i. Provisions that contain a waiver of rights to damages.
- ☐ j. Provisions that contain a waiver of obligations of good faith, fair dealing and commercial reasonableness.
- ☐ k. Provisions that attempt to change or waive rules of evidence or fix the method or quantum of proof to be applied in litigation or similar proceedings.
- ☐ l. Provisions for the appointment of a receiver.
- ☐ m. Forum selection clauses and consent to jurisdiction clauses (as to personal jurisdiction or subject matter jurisdiction).
- ☐ n. Provisions appointing one party as an attorney-in-fact for an adverse party.
- ☐ o. Waivers of rights to jury trials.
- ☐ p. Provisions requiring arbitration of disputes arising out of the transaction.
- ☐ q. Provisions that by their express terms state that fewer than all parties to the contract are entitled to recover attorneys' fees and expenses.
- ☐ r. Provisions that prohibit oral modifications.
- ☐ s. Indemnity of a party for damages arising out of its own misconduct.
- ☐ t. Self-help remedy provisions.
- ☐ u. Indemnification for securities law liabilities.
- ☐ v. Voting agreements.
- ☐ w. Other. Describe: _____

5. Which, if any, of the types of contractual provisions referred to in Question 4 does your firm customarily consider to be excluded by an “equitable principles limitation”** expressly or impliedly included in an opinion? Specify by reference to letters in Question 4:

** A typical “equitable principles limitation” is as follows:

The enforceability of the Company’s obligations under the Agreement is subject to general principles of equity, regardless of whether considered in a proceeding in equity or at law.

6. In real property transaction opinions, does your firm customarily refuse to issue opinions covering:

- ☐ a. Land use matters.
 - ☐ b. Environmental matters.
 - ☐ c. Leases.
 - ☐ d. Title.
 - ☐ e. Assignments of rents.
 - ☐ f. Other. Describe: _____
-

7. Does the following paragraph substantially describe your firm's customary practices in deciding whether and to what extent to conduct legal research in support of a remedies opinion?

When we give a remedies opinion: (i) we do not conduct legal research as to any provision of a contract covered by the opinion unless, in applying reasonable professional judgment to that provision, we recognize, without conducting legal research, that there is a not insignificant degree of uncertainty as to the enforceability of that provision based on the existence of California law directly applicable to our client, the transaction, or both; and (ii) we rely on general contract law principles to support an opinion as to the enforceability of such a provision in the absence of California law that we, in applying reasonable professional judgment to that provision, recognize, in accordance with (i) above, as being directly applicable to our client, the transaction, or both.

- ☐ a. Yes.
- ☐ b. No. How do your firm's customary practices substantially differ from this?

8. a. Does your firm customarily issue legal opinions governed by the 1991 Legal Opinion Accord of the ABA Business Law Section?

___ i. Yes.
___ ii. No.

- b. If you answered "Yes" in Question 8.a, are your firm's ABA Accord legal opinions customarily governed by the "California Provisions" as defined in the California State Bar Business Law Section's 1992 *Report on the Third-Party Legal Opinion Report of the ABA Section of Business Law*?

___ i. Yes.
___ ii. No.

- c. If you answered "Yes" in Question 8.a, are your firm's ABA Accord legal opinions in real property transactions customarily issued in accordance with the 1995 *California Real Property Legal Opinion Report* and the 1998 *First Supplement to 1995 California Real Property Legal Opinion Report*?

___ i. Yes.
___ ii. No.

9. [Answer only if your firm customarily issues remedies opinions under the law of states other than California, as well as under California law.] Do your firm's customary practices (as to the form of the opinion or exceptions/limitations/qualifications, as to legal research supporting the opinion, or otherwise) substantially differ when your firm issues remedies opinions under the law of states other than California than when issuing remedies opinions under California law?

___ a. No.
___ b. Yes. Please describe the substantial differences: _____

10. Would your responses to any of the above questions substantially differ when your firm is requesting a legal opinion rather than issuing one?

___ a. No.
___ b. Yes. Please describe the substantial differences: _____

11. Would the chair of your firm's Opinion Committee or another representative of your firm be willing to serve as an advisor to the Business Law Section's Task Force on Legal Opinions?

___ a. No.
___ b. Yes. If other than the person completing this survey, please specify:
Name: _____
Phone number: (____) _____

12. [Optional] Please attach the form(s) of California remedies opinion, and the applicable exceptions/limitations/qualifications, which your firm customarily issues.

13. [Optional] Please note any additional comments you think would be useful to the Task Force on Legal Opinions.

Thank you very much for completing this survey. Please return your response by **July 19**, 2001, to the address set forth in the Introduction.

APPENDIX 7

THIRD-PARTY LEGAL OPINION SURVEY RESPONSES

APPENDIX 7

THIRD-PARTY LEGAL OPINION SURVEY: SUMMARY OF RESPONSES RECEIVED AS OF 11/23/01 (Non-confidential version)

35 responses received out of 45 surveys sent (78% response rate). Note: there were actually 46 surveys sent, but one firm responded that it did not issue legal opinions so it could not answer any of the questions (so it was deleted from all summaries).

Size of law firm:

- a. up to 10 lawyers -- 2 (both California-only)
 - b. 11 to 100 lawyers -- 3 (2 are California-only)
 - c. more than 100 lawyers -- 30 (8 California-only)
- 14% (5 out of 35) 100 or less; 86% (30 out of 35) more than 100.

Is your firm a multistate law firm?

- a. Yes -- 23 (66%)
- b. No -- 12 (34%)

Does your firm have an Opinion Committee (or a designated group of lawyers within your firm) that (1) sets firm policy for the delivery of legal opinions and/or (2) approves (or a member of which approves) a legal opinion before the firm delivers the opinion?

See more detailed response chart

What is your current position in the firm?

See more detailed response chart

1. In what types of transactions does your firm customarily issue remedies opinions (assuming any legal opinion is given in the transaction)?

See more detailed response chart

2. When giving a remedies opinion with respect to the enforceability of a contract, does your firm customarily consider the opinion to include:

- a. Each and every provision of the contract -- 12 (34%). 10 of these are multistate (MS) firms; two are California-only (CA). 7 use a generic exception (3.a or 3.c) and 5 do not (3.b).
 - b. Only the essential, material or some similar subset of the contract's provisions -- 7 (20%). 4 MS; 3 CA. 6 use a generic exception and 1 does not.
 - c. My firm believes 2.b is customary, but as a precaution we prepare remedies opinions as if 2.a were applicable -- 16 (46%). 9 MS; 7 CA. 14 use a generic exception and 2 do not.
- a and c together aggregate to 28 (80%).
b and c together aggregate to 23 (66%).

3. Does your firm customarily include a "generic exception" when it issues remedies opinions?

- a. Yes -- 19 (54%). 12 MS; 7 CA.
 - b. No -- 8 (23%). 5 MS; 3 CA.
 - c. Only in certain types of transactions -- 8 (23%). 6 MS; 2 CA. Examples: secured transactions; leases; leveraged leases; financing transactions; debt financings.
- a and c together aggregate to 27 (77%).

4. Please indicate which, if any, of the following types of contractual provisions your firm customarily expressly excludes from its remedies opinions:

35 (100%) use some form of "laundry list".

31 (89%) listed at least 5 items, most far more than that.

5. Which, if any, of the types of contractual provisions referred to in Question 4 does your firm customarily consider to be excluded by an "equitable principles limitation" expressly or impliedly included in an opinion? Specify by reference to letters in Question 4:

See more detailed response chart

7. In real property transaction opinions, does your firm customarily refuse to issue opinions covering:

See more detailed response chart

7. Does the following paragraph substantially describe your firm's customary practices in deciding whether and to what extent to conduct legal research in support of a remedies opinion?

When we give a remedies opinion: (i) we do not conduct legal research as to any provision of a contract covered by the opinion unless, in applying reasonable professional judgment to that provision, we recognize, without conducting legal research, that there is a not insignificant degree of uncertainty as to the enforceability of that provision based on the existence of California law directly applicable to our client, the transaction, or both; and (ii) we rely on general contract law principles to support an opinion as to the enforceability of such a provision in the absence of California law that we, in applying reasonable professional judgment to that provision, recognize, in accordance with (i) above, as being directly applicable to our client, the transaction, or both.

- a. Yes -- 29 (83%). 20 MS; 9 CA.
- b. No -- 6 (17%). 3 MS; 3 CA. How do your firm's customary practices substantially differ from this? Examples -- don't know what this means; do appropriate factual and legal due diligence; review each provision for enforceability; do legal research; apply what should know.

8.
 - a. Does your firm customarily issue legal opinions governed by the 1991 Legal Opinion Accord of the ABA Business Law Section?
 - i. Yes -- 6 (17%). 3 MS; 3 CA.
 - ii. No -- 29 (83%). 20 MS; 9 CA.
 - d. If you answered "Yes" in Question 8.a, are your firm's ABA Accord legal opinions customarily governed by the "California Provisions" as defined in the California State Bar Business Law Section's 1992 *Report on the Third-Party Legal Opinion Report of the ABA Section of Business Law*?
 - i. Yes -- 6. 3 MS; 3 CA.
 - ii. No -- 0
 - e. If you answered "Yes" in Question 8.a, are your firm's ABA Accord legal opinions in real property transactions customarily issued in accordance with the 1995 *California Real Property Legal Opinion Report* and the 1998 *First Supplement to 1995 California Real Property Legal Opinion Report*?
 - i. Yes -- 5. 3 MS; 2 CA.
 - ii. No -- 0

9. [Answer only if your firm customarily issues remedies opinions under the law of states other than California, as well as under California law.] Do your firm's customary practices (as to the form of the opinion or exceptions/limitations/qualifications, as to legal research supporting the opinion, or otherwise) substantially differ when your firm issues remedies opinions under the law of states other than California than when issuing remedies opinions under California law?

22 responses out of 35 respondents (63%)

- a. No -- 16 (73% of 22 responses). 14 MS; 2 CA. 13 of these 16 (81%) use the "essential terms" approach (2.b), a generic exception (3.a or 3.c), or both. Only 1 of these 13 uses the "essential terms" approach but not a generic exception.
- b. Yes -- 6 (27% of 22 responses). 6 MS; 0 CA. Please describe the substantial differences. Examples -- fewer exceptions/qualifications in NY and Illinois opinions; don't use "laundry list" outside CA; exceptions vary according to state law.

11. Would your responses to any of the above questions substantially differ when your firm is requesting a legal opinion rather than issuing one?

See more detailed response chart

11. Would the chair of your firm's Opinion Committee or another representative of your firm be willing to serve as an advisor to the Business Law Section's Task Force on Legal Opinions?

27 affirmative responses (including some current Task Force participants)

12. [Optional] Please attach the form(s) of California remedies opinion, and the applicable exceptions/limitations/qualifications, which your firm customarily issues -- 9 responses included this.

13. [Optional] Please note any additional comments you think would be useful to the Task Force on Legal Opinions -- 12 responses to this, summarized as follows:

Task Force should look at inconsistent use of exceptions in lending vs. securities/M&A transactions.

Any State Bar move to an “each and every” approach would put an enormous burden on the opinion giver, multiplying manyfold the number of required exclusions.

Opinion recipients vary greatly as to what they perceive as key elements of opinion. Many prefer specific list of exceptions to highlight potential problem areas re enforceability.

Their opinions use Accord language but don’t incorporate or refer to Accord.

Difficult opinion issues include:

1. Extent of remedies opinion exceptions (the most difficult issue).
2. Quasi-factual statements, such as “no litigation”.
3. Opinions requiring proof of absence of something, such as “no required consents or approvals”.
4. Attorney-client privilege waivers arising from, for example, nothing has come to our attention re any misleading statements in prospectus.

Would prefer to streamline the opinions process and form a la TriBar, but reluctant to part from the herd. Would like to help the Task Force move in that direction.

Opinion practice getting out of control. Opinions are rarely useful and cause way too much adversity and expense.

“Matters to opine on in various deals”

The Task Force should try to close unnecessary gap between Calif. and NY opinion practices. Would like to help it do so.

Opinions are heavily negotiated, so many times we don’t follow our standard practices.

Opinions vary based on circumstances, so “it is misleading to report customary practices”.

Need State Bar guidance re Calif. lawyers opining on documents governed by non-Calif. law.

APPENDIX 8

APPLICATION OF CUSTOMARY PRACTICE TO THE REMEDIES OPINION

The Meaning and Scope of the Remedies Opinion

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APPENDIX 8

APPLICATION OF CUSTOMARY PRACTICE TO THE REMEDIES OPINION

The meaning and Scope of the Remedies Opinion

I. INTRODUCTION

This appendix addresses a historic disagreement about the remedies opinion. Does this opinion cover “each and every” contractual undertaking of a party to the contract (the “New York view”) or only the “essential provisions” (the “California view”)”? The resolution is that opinions practice has evolved to a point where lawyers (and their clients) should cease debating this issue. Opinion givers will be better off focusing their energies on conforming to customary practice, which is now generally uniform among those who regularly give remedies opinions, wherever located. Opinion recipients should be satisfied with the professional judgment provided them in remedies opinions prepared in accordance with customary practice.

A difference in practice in the use of stated exceptions to the remedies opinion between some who adhere to the California view and many who adhere to the New York view is addressed at V below.

A. The “California View”: “Essential Provisions.”

Many California opinion givers contend that the “essential provisions” interpretation should satisfy the due diligence interests of opinion recipients and at the same time provide a reasonable allocation of risk and cost. They feel that the application of the “each and every” interpretation may impose or imply an unreasonable and unnecessary legal diligence requirement for the opinion giver. They believe that it exposes the opinion giver to unreasonable risks of liability, embarrassment and loss of reputation, and unnecessarily increases the time and financial costs of transactions. They worry that this is a more serious problem for California opinion givers than for others, because they believe that California judges have an unusual tendency to “do equity” and to ignore the precise language of contracts, if that appears to them necessary to achieve a “fair” result.¹ By interpreting the remedies opinion as applying only to the “essential

¹ See Bus. Law Section of the State Bar of Cal., *Report on the Third-Party Legal Opinion Report of the ABA Section of Business Law* § III G 2 (1992) [hereinafter *1992 Report*], republished in Bus. Law Section & Real Prop. Section of the State of California, *California Opinion Reports* at IV (2002) [hereinafter *2002 Compendium*].

provisions” of a contract, these opinion givers believe that they have limited their legal diligence requirement.

Many of these opinion givers also tend both to use a generic exception² in conjunction with the remedies opinion and to state separately a large number of express exceptions (sometimes referred to as a “laundry list”).³ Some feel that these exceptions are necessary in case the “each and every” interpretation prevails, because otherwise they may be required unreasonably to know or research the law relating to every undertaking in the contract covered by the opinion.⁴

B. The “New York” View: “Each and Every”.

Other lawyers, including many who regularly represent opinion recipients, contend that each and every undertaking is covered by the remedies opinion (unless expressly or implicitly excluded from coverage), in fulfillment of the legitimate diligence needs of opinion recipients.⁵

Many of these lawyers state few exceptions when giving remedies opinions. Many also believe that laundry lists and a generic exception are often over-used in “California” remedies opinions, and are sometimes cumulated in a way that seriously undermines the usefulness of the opinions. They contend that the reasons for not enforcing many undertakings in contracts are not covered by a remedies opinion, because by customary usage either the equitable principles limitation or the bankruptcy exception⁶

² For a discussion of the generic exception, including its text, see the *Report of the Generic Exception Subcommittee*, attached *infra* as Appendix 11.

³ See generally § V *infra*; App. 10.

⁴ Some of these opinion givers may feel that some or many of the nonessential provisions, in context, are either unenforceable or of questionable validity. For example, sometimes heavily negotiated documents contain undertakings that are very broad or vague, or are not clearly drafted, giving rise to uncertain enforceability. See also *supra* App. 4 § II C (questionable provisions that have been drafted or retained by lawyers for the benefit of their clients). These issues appear to have received little attention in opinion literature.

Some seek to use the generic exception and laundry lists even when they believe that the essential provisions interpretation applies.

⁵ See The TriBar Opinion Committee, *Third-Party Closing Opinions*, 53 Bus. Law 591, 621, n. 69 and accompanying text (1998) [hereinafter *1998 TriBar Report*].

Those who adhere to the “essential provisions” interpretation may believe that it limits their exposure to liability in cases where the opinion giver has failed to warn that a nonessential provision is unenforceable. However, holders of the New York view contend that this belief is ill-placed. Distinguishing between essential and nonessential provisions is inherently difficult. Moreover, in litigation seeking damages from an opinion giver for a wrong remedies opinion, the plaintiff will need to allege and prove damages resulting from its reliance on the incorrect opinion. If the plaintiff does so, the opinion giver could have difficulty convincing the trier of fact that the relevant unenforceable provision is nonessential.

⁶ See *infra* App. 10, § I.B.

is understood to exclude those reasons, or because the reasons are understood to be otherwise beyond the scope of the remedies opinion.⁷ Some also contend that California courts today do not have an unusual tendency to ignore the express provisions of contracts and, therefore, that this worry does not justify the laundry list approach.

Several of these issues are addressed or touched on in the Umbrella Report and other appendices.⁸

II. BACKGROUND

A. Background and Evolution of the Disagreement over the Meaning and Scope of the Remedies Opinion.

The “California view” is found in the 1989 Report of the Corporations Committee of the California Business Law Section, and the “New York” view is articulated in the ABA Accord and various reports of the New York-based TriBar Opinion Committee. The Section accepted the “each and every” approach in its 1992 Report about ABA Accord opinion letters, but only if modified by (1) all of the qualifications, limitations and assumptions found in the Accord, (2) additional exceptions (identified as the “California Qualifications”) that are spelled out in the 1992 Report, and (3) an appropriate articulation of the legal diligence responsibility of the opinion giver.⁹ The

⁷ See *infra* § V.

The “New York” broad application of customary usage may have evolved to the point that it is little different in practice from the “essential provisions” approach. For example, the 1998 TriBar Report states that the equitable principles limitation “. . . covers those situations in which a court may decline to give effect to a contractual provision because the enforcing party has not been significantly harmed as where an alleged breach is not material and has not resulted in any meaningful damage to the party seeking enforcement.” 1998 *TriBar Report* at 625. Query how different the use of concepts of significant harm, material breach and meaningful damage is from a determination that, in context, the provision is “nonessential.” See *infra* App. 10, § I.B.2 (touching on the concept of materiality as part of the equitable principles limitation). Cf. Assoc. of the Bar of the City of N.Y. and the N.Y. State Bar Association, 1998 *Mortgage Loan Opinion Report*, 26 N.Y. REAL PROP. J. 2, 18–19 (1998) (commenting (in support of a form of generic exception that expressly assumes a material default) that the existence of a material default depends on future facts and circumstances that are unknown at the time the opinion is issued).

⁸ See *Report on Third-Party Remedies Opinions* to which this appendix is attached §§ VI, VII & VIII (2004) [hereinafter *Umbrella Report*]; *infra* App. 9 (comparison of enforcement of contracts by courts under New York and California law); *infra* App. 10 (analysis of the need for separately stated exceptions); *infra* App. 11 (analysis of the generic exception).

⁹ In part, this was an attempt to bridge the gap between the two competing views.

The 1992 Report included in its articulation of the legal diligence responsibility the following: “The Opinion Giver need not conduct legal research as to any such [undertaking] unless the Opinion Giver, in applying reasonable professional judgment to that [undertaking], should recognize, without conducting legal research, that there is a not insignificant degree of uncertainty as to the enforceability based on the existence of California Law (or federal Law, if the Opinion is also given under federal Law) directly applicable to the Client, the Transaction, or both.” 1992 *Report* § III.C.(b)(ii).

approach set forth in this appendix is consistent with that of the 1992 Report, but reflects recent evolution of national opinion practice.

B. What is the solution?

The debate between holders of the California view and those of the New York view should cease, because it focuses on the wrong question. Concerns of California opinion givers about liability and reputation risks of an incorrect remedies opinion and undue costs of legal diligence are better addressed by identifying and exercising customary practice in the preparation of remedies opinions. Following is a discussion of the core concern of liability, including a general description of the customary practice of many opinion givers who regularly give remedies opinions. IV below addresses questions of embarrassment, reputation and cost.

III. LIABILITY

A. The Standard of Care.

1. *Background.*

A third-party legal opinion is not a guaranty of a particular result. Rather, it is an expression of professional judgment.¹⁰ Liability for a wrong opinion is based on breach of a duty owed by the opinion giver. While other theories can result in liability,¹¹

Many believe that the statement of this portion of the standard for legal diligence is not felicitously worded. Nevertheless, when provided with this articulation, 83% of the firms that responded to the 2001 Survey stated that it substantially describes their practice in deciding whether and to what extent to conduct legal research in support of a remedies opinion. *See supra* App. 7 § 7.

See infra § III.B.1.

¹⁰ The Am. Bar Ass'n. Comm. on Legal Opinions, *Legal Opinion Principles*, 53 BUS. LAW. 831, § I.D (1998) [hereinafter *ABA Principles*]; The Am. Bar Ass'n. Comm. on Legal Opinions, *Third-Party Legal Opinion Report, Including the Legal Opinion Accord of the Section of Business Law, American Bar Association*, 47 BUS. LAW. 167, Foreword at p. (iii) (1991) [hereinafter *Accord Report*]; 1998 TriBar Report § 1.2(a); Comm. on Corp. of the Bus. Law Section of the State Bar of Cal., *1989 Report of the Committee on Corporations Regarding Legal Opinions in Business Transactions*, 45 Bus. Law. 2169, § II (1990), § II, republished in the *2002 Compendium* at II [hereinafter *1989 Report*]. As of September 2004, the Corporations Committee of the Section is preparing a report that revises, restates and supersedes the *1989 Report*. *See also* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 95 cmt. c (2000) [hereinafter RESTATEMENT].

¹¹ E.g., aiding and abetting wrongs of another person, violation of securities laws, fraud and misrepresentation. As with the duty of care, the extent of the risk of liability under these theories does not seem to expand or contract based on whether the remedies opinion is interpreted as covering “essential provisions” or “each and every” undertaking. *Cf. Vega v. Jones, Day, Reavis & Pogue*, LA Super Ct. #BC295541 (2004) (refusal by trial court to dismiss an action for fraud, not based on a legal opinion, on demurrer, where the law firm allegedly failed to disclose to an adverse party in a merger transaction facts the court felt were material).

the relevant theory is based on an alleged breach of the duty of care owed by the opinion giver to the opinion recipient.

According to California case law, a lawyer is expected, in his or her practice, to be well informed and to exercise “such skill, prudence and diligence as lawyers of ordinary skill and capacity commonly possess and exercise in the performance of the tasks which they undertake.”¹² The Restatement (Third) of the Law Governing Lawyers describes this general duty largely in the same way, expressing a requirement for lawyers to exercise “competence and diligence normally exercised by lawyers in similar circumstances.”¹³ Both articulations stress the requirements of competence and diligence, and use the practice of other lawyers as the primary point of reference.

The authors of the California 1989 Report did not find any case law or Bar canon that clearly articulated the standard of care imposed on opinion givers under California law.¹⁴ That report recites general standards of care owed to a lawyer’s own client, and then appears to suggest that they likely also apply to the duty owed to a third-party opinion recipient.¹⁵ In preparing this report, the Opinions Committee likewise discovered no relevant reported California cases articulating the scope of the duty of care applicable to these opinions.¹⁶ Most other literature on third-party closing opinions does not deal extensively with the standard of care.¹⁷

¹² *Lucas v. Hamm*, 56 Cal.2d 583, 591, *cert. denied*, 368 U.S. 987 (1961) (finding a lawyer not liable for preparing a will that violated the rule against perpetuities because a lawyer of ordinary skill in similar circumstances might have made a similar error); *Betts v. Allstate Ins. Co.*, 154 Cal.App.3d 688, 715, (1984). *See also* RESTATEMENT (SECOND) OF THE LAW OF TORTS § 299A (1965) [hereinafter Restatement of Torts] (“Unless he represents that he has greater or less skill or knowledge, one who undertakes to render services in the practice of a profession or trade is required to exercise the skill and knowledge normally possessed by members of that profession or trade in good standing in similar communities.”). In a malpractice action against a lawyer by his own client arising out of his representation of the client in a divorce proceeding, the California Supreme Court supplemented the *Lucas v. Hamm* articulation by stating that a lawyer is expected “to discover rules of law which, although not commonly known, may readily be found by standard research techniques.” *Smith v. Lewis*, 13 Cal.3d 349, 358 (1975). In that case, the Court noted that the lawyer would have been aware of an error in analysis with “minimal research into hornbook or case law,” and the quoted language therefore may be dictum. However, the language has been used in some subsequent cases. *See discussion infra* at § III B 2.

¹³ RESTATEMENT, *supra* n. 10, § 52(1). California courts give heavy weight to Restatements. This is true both for the RESTATEMENT and for the RESTATEMENT OF TORTS, *supra* n. 12, which are the most relevant Restatements for purposes of this discussion. Through March 1, 2004, California courts had cited those Restatements (in all versions) a total of 4,073 times. Although the RESTATEMENT’S formulation varies somewhat from *Lucas v. Hamm* and related cases, the Opinions Committee believes that the articulations have substantially the same meaning. *See infra* n. 18 and related text.

¹⁴ 1989 Report § III.

¹⁵ *See infra* n. 19 and accompanying text.

¹⁶ *Roberts v. Ball, Hunt, Hart & Baerwitz*, cited in the 1989 Report, was a reversal by the Court of Appeal of the trial court’s grant of a demurrer in an action by a creditor of the opinion giver’s client who received an opinion letter originally given to that client. The complaint did not allege that the opinion was incorrect,

2. *The Restatement.*

In the absence of defining California case law, reference is appropriate to other authorities that address principles applicable to the liability of opinion givers. The Restatement does so and deserves great weight, because it seeks to restate authoritatively existing law.¹⁸ According to the Restatement, an opinion giver owes a duty of care to the opinion recipient, as well as to its own client.¹⁹ As noted above, the components of the duty of care are diligence and competence.²⁰

Satisfaction of the diligence and competence standards requires the competence and diligence normally exercised by lawyers in similar circumstances.²¹ This in turn requires reference to customary practice.²² In general, the giver of a remedies opinion should satisfy its duty of care if it exercises the diligence and meets the competence standards that lawyers who regularly give opinions of the kind involved in similar

but the appellate court reversed on the basis that an allegation in the complaint that the opinion failed to disclose material facts stated a cause of action for negligent misrepresentation. 57 Cal.App.3d 104 (1976).

¹⁷ But see the discussion of §§ 2 and 10 of the Accord Report, *supra* App. 5 n.26.

California cases addressing the duty of care owed to a non-client outside of the third-party opinion letter context tend to focus on whether the duty is owed to the non-client, and do not articulate clearly the scope of the duty. See, e.g., B.L.M. vs. Sabo & Deitsch, 55 Cal.App.4th 823 (1997); Mattco Forge, Inc. vs. Arthur Young & Company, 38 Cal.App.4th 1337 (1995); Held vs. Arant, 67 Cal.App.3d 748 (1977); Goodman vs. Kennedy, 18 Cal.3d 335 (1976); Biakanja vs. Irving, 49 Cal.2d 647 (1958). See also the discussion of Smith v. Lewis, 13 Cal.3d 349 (1975), cited in the 1989 Report, and related cases, *infra* § III.B.2.

¹⁸ See also RESTATEMENT OF TORTS § 552, *supra* n. 12; *supra* n. 13.

¹⁹ RESTATEMENT § 51(2); see also *id.* § 95(1). This appendix does not undertake a comprehensive review of all of the elements required to establish liability, e.g., reliance and causation, but rather addresses only the outline of the duty of care.

²⁰ *Id.* § 52(1); see also MODEL RULES OF PROF'L CONDUCT R. 1.1 (Competence), 1.3 (Diligence); CAL. R. OF PROF'L CONDUCT 3–110 (Competence and Diligence). Rules of professional conduct are not usually used to establish liability, but may be used as evidence of the standard of care. See *supra* App. 5 § II.

²¹ See *supra* n. 13 and related text. There might be disagreement about the meaning of “lawyers in similar circumstances.” See generally *supra* App. 5 §§ IV & V (uncertainties arising from the use of customary practice); language quoted from the RESTATEMENT OF TORTS, *supra* n. 12. Regarding closing opinions generally, Appendix 5 cites references in *ABA Principles* § I.B to the customary practice of lawyers who regularly give, and lawyers who regularly advise opinion recipients regarding, opinions of the kind involved. In the context of remedies opinions, that Appendix concludes that it would be prudent for opinion givers to assume that courts will apply a standard of customary practice as exercised by lawyers who regularly give opinion letters in similar transactions. The discussion in Appendix 5 also touches on such questions as the geographic location of lawyers used to measure customary practice and customary practice for handling specialized matters.

²² See, e.g., RESTATEMENT, *supra* note 10, § 52(1); *id.* cmt. b (competence); *infra* n. 26 (diligence). Sometimes more general reference is made to that which is reasonable or appropriate in the circumstances, but the discussion always returns to competence and diligence that lawyers exercise. See RESTATEMENT § 95 cmt. c & reporter’s note; *id.* § 52 cmt. b.

transactions exercise and meet.²³ The opinion recipient should be satisfied if the opinion giver meets these standards.

The following discusses customary practice for legal diligence and competence in rendering remedies opinions.

B. Legal Diligence.

A closing opinion requires factual²⁴ and legal diligence.²⁵ In the case of the remedies opinion, legal diligence means the process of considering how the law covered by the opinion applies to the contract in question.

1. *Customary Legal Diligence.*

According to the Restatement, customary practice is a primary determinant of the nature and extent of the legal diligence required to be employed by the opinion giver in preparing and giving an opinion letter.²⁶ Opinion givers are prudent to assume that customary practice for remedies opinions is the practice of lawyers who regularly give opinions of the kind involved in similar transactions.²⁷ Many experienced opinion givers take the same or similar legal diligence steps in giving remedies opinions, regardless of

²³ While this conclusion is supported by the text and the footnotes in this appendix, there are situations where it would not be correct, for example where the parties have agreed to a different standard.

²⁴ This appendix does not discuss factual diligence. *See* 1998 TriBar Report § II (discusses facts).

²⁵ *See generally* 1989 Report § III; 1998 Tribar Report § 1.4 (c). This appendix addresses only legal diligence for the remedies opinion.

²⁶ “ Unless effectively stated or agreed otherwise, a legal opinion . . . constitutes an assurance that it is based on legal research and analysis customary and reasonably appropriate in the circumstances and that it states the lawyer’s professional judgment as to how any legal question addressed in the opinion would be decided by the courts in the applicable jurisdiction on the date of the [opinion].” RESTATEMENT § 95 cmt. c. “Similarly, once the form of opinion has been agreed on, customary practice will also determine the nature and extent of the factual and legal diligence to be employed by the opinion giver in connection with the issuance.” *Id.* § 95 cmt. e. A reporter’s note on Restatement § 95 states that various bar association reports that purport to be mainly declaratory of custom and practice have been instrumental in furthering understanding of the evaluation process and contributing to uniformity of practice among lawyers issuing legal opinions, citing various TriBar reports and the ABA Principles. *Id.* § 95 cmt. c. reporter’s note.

²⁷ *See supra* n. 21.

the geographical location and regardless of the applicable law.²⁸ These steps are as follows:²⁹

1. One or more competent³⁰ opinion preparers,³¹ who are reasonably current in developments in applicable law and practice, read the entire relevant contract carefully; that reading necessarily includes each and every undertaking in the contract.³²
2. If the opinion preparers recognize in the process of that review that a particular undertaking is not enforceable, or that an issue gives rise to a significant degree of uncertainty as to the enforceability of an undertaking, they then determine whether the remedies opinion, after considering the exclusionary effect of general exceptions, customary usage and other factors, would cover the issue giving rise to that uncertainty or unenforceability.³³
3. If the opinion would cover the issue, the opinion preparers do what is reasonably necessary to resolve any significant uncertainty. This may include reliance on their knowledge of the law (including general principles of contract law), consultation with lawyers with relevant experience or expertise, or in appropriate cases legal research.³⁴ Typically, the opinion preparers already are

²⁸ Some law firms have multiple offices, including offices in California and in other states. In general, these firms give opinions under the law of each jurisdiction where they have an office, and report little difference in their legal diligence approach.

²⁹ This appendix sets forth the Opinions Committee's consensus view of practices of many lawyers who regularly deliver remedies opinions. Other practices may also meet the "customary practice" standard. Moreover, as illustrated by notes 31 and 36, details of how experienced opinion givers act in rendering opinions vary.

³⁰ See discussion § III.C. *infra*.

³¹ An opinion preparer is a lawyer in a law firm who prepares the opinion letter. The opinion giver is the lawyer or law firm in whose name the opinion is signed. See *supra* App. 1. Details vary as to how different experienced opinion givers use opinion preparers in this process. In some circumstances, for example in complex transactions where the opinion giver is a large law firm, experienced opinion givers involve more than one opinion preparer. Different parts of the documentation may require different expertise, or the opinion may cover many different documents or even several related transactions. Some opinion givers delegate review of relatively straight-forward undertakings to less experienced lawyers under the supervision of a senior lawyer. See notes 29 & 36.

³² This provides the assurance that the opinion preparers have considered each and every undertaking.

The purpose of this review is to determine whether the opinion preparers, using their knowledge, background and skill, and reasonable professional judgment, recognize unenforceability, or a significant degree of uncertainty as to the enforceability of, one or more of the undertakings of the contract. While the steps in the diligence process may in some cases merge, the opinion preparers do not typically undertake legal research in making that determination.

³³ For a discussion of generally understood limitations on the scope of a remedies opinion, see *infra* § V.

³⁴ The law covered by the opinion is discussed *infra*, n. 52.

aware of the current state of law relating to many of the undertakings in the contract.³⁵

4. If the opinion preparers still are not satisfied that the undertaking is enforceable, they then include in the opinion letter an exception that expressly excludes or limits coverage of the provision.³⁶

In this entire process, the opinion preparers use reasonable professional judgment.³⁷ It is this professional judgment that the opinion recipient seeks.

2. A Further Note on California Case Law.

In the context of malpractice actions by clients against their lawyers, a line of California cases includes the following in its articulation of the legal diligence duty. Lawyers are expected “. . . to possess knowledge of those plain and elementary principles of law which are commonly known by well-informed attorneys, *and to discover those additional rules of law which, although not commonly known, may readily be found by standard research techniques.*”³⁸ Some fear that these cases could be read to impose on a California opinion giver a duty to opinion recipients to know or research the law applicable to the enforceability of every contractual undertaking of the opinion giver’s client.³⁹ The concern is that these cases if read that way would impose an inordinately high level of legal diligence and knowledge, with attendant time and monetary costs, and would expose opinion givers to a high risk of liability.

³⁵ See *infra* § III C 1.

See also The TriBar Opinion Committee, *The Remedies Opinion -- Deciding When To Include Exceptions And Assumptions*, 59 Bus. Law. 1483, 1487 (2004):

The opinion preparers normally will not have to conduct legal research on every contractual provision each time they render an opinion. For many common provisions, the opinion preparers’ existing knowledge and experience typically will be sufficient without further research to permit them to address the legal issues presented.

³⁶ See *infra* App. 10 Ann. A (examples of exceptions). Further details of how this legal diligence is carried out vary from firm to firm. For example, some firms require review of third-party opinions by an opinion committee or a second partner to help assure the quality of their opinions practice. Others do not. See *supra* n. 29.

³⁷ 1992 Report § III D 1. The combination of competence, § III C, *infra*, and customary diligence conducted with reasonable professional judgment is at the heart of this process. See *supra* § III A.

³⁸ *Smith v. Lewis*, 13 Cal.3d 349 (1975); *Camarillo v. Vaage*, 105 Cal. App. 4th 552, 561 (2003); *Stanley v. Richmond*, 35 Cal. App. 4th 1070, 1092 (1995). Emphasis added.

³⁹ Some California opinion givers have concern that 1989 Report § III might be read to support an extension of the legal diligence standard articulated in *Smith v. Lewis* to givers of third-party remedies opinions, by stating that “the same or similar standards no doubt apply” to “rendering legal opinions.” As is evident in the following text, the Section believes that such an extension is inappropriate.

All of these California cases involve the duty of a lawyer to the lawyer's own client in a variety of factual contexts; they do not address the duty of an opinion giver to a third party. While statements in opinion literature suggest that a duty of care is owed both to a client and an opinion recipient,⁴⁰ those references are to the existence of a duty and its general meaning (*i.e.*, the requirements of competence and diligence). However, application of the general principles differs between client and non-client situations.⁴¹ For example, absent a misleading opinion, an opinion giver is not obligated to provide advice beyond the opinion's scope, as it might be for a client.⁴²

As discussed under *Customary Legal Diligence* above, customary practice for remedies opinions is to exercise reasonable professional judgment in identifying enforceability issues with every undertaking in the contract. It does not call for knowledge or research of the law relating to every undertaking (except to the extent required by that professional judgment). This line of cases concerning a lawyer's duty to its own client should not be interpreted as defining the duty of care to opinion recipients differently from customary practice.

A contrary view could hold opinion givers accountable for addressing not only enforceability issues that would be recognized by a competent lawyer in a careful review of the contract, but also for almost **any** enforceability issue (no matter how obscure) that could be recognized by an omniscient lawyer. This view is incorrect for reasons discussed earlier in this segment III:

1. A legal opinion is an expression of professional judgment, not a guaranty or absolute assurance.⁴³
2. The proper scope of legal diligence in the context of third-party closing opinions is governed largely by customary practice, likely as exercised by opinion givers experienced in rendering such opinions in transactions of the same type.⁴⁴
3. Customary practice and the applicable standard of care call for legal diligence by competent opinion preparers using reasonable professional judgment, not absolute perfection by an omniscient attorney.

⁴⁰ See RESTATEMENT § 51; 1989 Report § III.

⁴¹ In non-client matters, the duty of care “must be applied in light of the scope and rationale of the duty in question.” RESTATEMENT § 52 cmt. e.

⁴² “In rendering an evaluation, a lawyer does not undertake to advise the third person except with respect to the questions actually covered by the evaluation.” *Id.* § 95 cmt. c. See Accord Report, Accord § 18; A. N. Field, *Legal Opinions in Business Transactions* §3.5 (Practicing Law Institute 2003) (discussing the “Four Corners” approach).

⁴³ See *supra* note 10.

⁴⁴ See *supra* § III B 1, n. 21, App. 5 § IV B.

Moreover, more extensive legal diligence would in many cases be prohibitively expensive.⁴⁵

C. Competence.

As with diligence, the competence component of the duty of care is defined by the competence normally exercised by lawyers in similar circumstances, requiring reference to “normal professional practice,” *i.e.*, customary practice.⁴⁶ The professional community whose practice is relevant is lawyers undertaking similar matters in the relevant jurisdiction.⁴⁷ It is prudent for opinion givers to assume that competence for remedies opinions is measured by the competence of lawyers who regularly give opinions of the kind involved in similar transactions.⁴⁸ While the “relevant jurisdiction” could be a state, the Restatement favors a national standard for competence.⁴⁹ Moreover, where a national practice exists there may be national standards,⁵⁰ and it appears that many aspects of opinion practice are now national.⁵¹

1. *Relevant Law.*

In meeting the requirement of competence, experienced opinion givers expect opinion preparers working on remedies opinions to be reasonably current in developments in the relevant law of the opining jurisdiction.⁵² This expectation may be

⁴⁵ For a discussion of the cost/benefit analysis applicable to remedies opinions, see *supra* App. 4.

⁴⁶ RESTATEMENT § 52; *id.* § 52 cmt. b. While the Restatement does not use the term “customary practice” in its discussion of competence, there does not appear to be a difference between “normal professional practice” and “customary practice.”

⁴⁷ *Id.* § 52 cmt. b. See *supra* App. V § IV B.

⁴⁸ See *supra* note 21; *supra* App. 5 § IV B.. “Normal professional practice” does not mean “average” performance; the duty is one of reasonableness in the circumstances. RESTATEMENT § 52 cmt. b. See *supra* note 22.

This does not foreclose a lawyer from giving a remedies opinion where the lawyer has not regularly given them before. However, opinion givers should understand the importance of having sufficient legal knowledge to recognize issues with undertakings in the contracts in question at a level that will meet that competence standard. Moreover, opinion preparers are well advised to have sufficient knowledge of customary opinion practice to understand the diligence required and the impact of customary usage on the scope and meaning of the opinion. While it may be possible or even necessary to achieve some of the required level of competence in the course of a particular transaction, it could be difficult to achieve all of it in that time frame. Examples of techniques used by many to achieve and maintain that competence level are set forth below, and the Umbrella Report and its appendices (including this appendix), and other reports referred to therein, are particularly useful in providing background on relevant customary practice.

⁴⁹ RESTATEMENT § 52 cmt. b.

⁵⁰ *Id.*

⁵¹ See App. 5 § IV A.

met by some combination of regular reading of current publications, attendance at or preparation of educational programs, consultation with experienced lawyers, personal experience in the practice, legal research and other techniques. Many opinion givers strongly prefer that one or more opinion preparers have experience working in transactions and with documentation of the same type. Knowledge gained using the foregoing techniques helps opinion preparers to recognize legal issues raised by transactional documentation.

Where the contract in question includes undertakings requiring knowledge in a recognized area of legal specialty, experienced opinion givers typically assure that at least one of the opinion preparers is knowledgeable in that specialty. If the opinion giver does not have a lawyer with that specialty, it will usually refer responsibility for those undertakings to a specialist.⁵³

2. Opinion Practice.

Many opinion givers who regularly render remedies opinions⁵⁴ also seek to assure that some or all of the opinion preparers maintain currency in their understanding of the relevant customary opinion practice. As is the case with competence in the relevant law, this currency may be achieved by, for example, reading literature on the topic (including Bar Association reports on legal opinions), attending educational programs, personal experience in the practice, and consulting with experienced lawyers. Many also strongly prefer that one or more opinion preparers have significant experience in preparing and giving closing opinions. The foregoing techniques are designed to assure that opinion preparers have an appropriate understanding of customary opinion usage and diligence.

⁵² The Accord states that “The Remedies Opinion deals only with the law of contracts of the Opining Jurisdiction and other laws that a lawyer in the Opining Jurisdiction exercising customary professional diligence would reasonably recognize to be directly applicable to the Client, the Transaction or both.” *Accord Report*, Accord § 10. The 1998 TriBar Report concurs that the opinion deals with the relevant contract law, and that: “Customary practice requires the opinion preparers to take account of law that lawyers who render legal opinions of the type involved would reasonably recognize as being applicable (i) to transactions of the type covered by the agreement and (ii) to the role of the Company (but not other parties to the agreement) in the transaction.” *1998 TriBar Report* § 3.5.1. Certain areas of law that might meet these standards are nevertheless understood not to be covered unless specifically included, *e.g.*, securities and antitrust laws. See *Accord Report*, Accord §19; *1998 TriBar Report* § 3.5.2; *infra* App. 10, at 12–15.

In general, lawyers who regularly work on transactions similar to the one at hand have thereby acquired knowledge of applicable law, which assists them in recognizing legal issues with the documentation.

⁵³ The 1989 Report states that, when a legal matter falls within a recognized specialty, courts impose a duty on a general practitioner to refer the client to a specialist, if under the circumstances a reasonably careful and skilled practitioner would do so. It further states that courts have judged attorneys rendering advice with respect to matters within a legal specialty by “the standard of whether they possessed the knowledge and skill ordinarily possessed [competence], and whether they exercised the care and skill ordinarily used [diligence], by a specialist in similar circumstances.” *1989 Report* § III n.12 (citing cases that involve claims by clients against their attorneys, and not claims by opinion recipients or other third parties); see also *supra* App. 5, n. 26.

⁵⁴ And many opinion recipients that regularly receive opinion letters, as well.

Experienced opinion givers also often use other techniques to help assure that they are bringing the full weight of their competence to bear on closing opinions.⁵⁵

IV. REPUTATION AND COST EFFECTIVENESS

A. Embarrassment and Reputation.

While liability for a wrong opinion is an important concern for opinion givers, for many loss of reputation is at least as important. A reputation for rendering wrong or poorly thought out opinions is not only embarrassing, but could cause opinion recipients to refuse to accept the opinion giver's closing opinions, and clients to cease relying on the opinion giver's work.

Just as with efforts to satisfy the standard of care, conformity with customary practice by an opinion giver should provide major protection for its reputation. However, if customary practice is followed and an undertaking covered by the opinion letter proves to be unenforceable, embarrassment and reputation issues may still result.⁵⁶ The risk, however, does not depend on whether an "each and every" or an "essential provisions" interpretation of the remedies opinion is used.

B. Cost Effectiveness.

As noted in the Threshold Subcommittee Report,⁵⁷ lawyers and clients generally are interested in reducing time and costs in transactions. Exercise by the opinion giver of customary diligence and competence in preparing and giving a remedies opinion usually will result in a reasonable scope of work for the opinion giver, while meeting the reasonable due diligence needs of the opinion recipient. Debating whether the remedies opinion covers each and every undertaking or essential provisions is not productive, because customary practice appears to be the same either way. Accordingly, there should be little difference in cost. If disproportionate cost will be incurred in a particular transaction for any reason, lawyers and clients should discuss that issue and seek to find ways to reduce the cost by limiting the scope of work.

V. EXCEPTIONS

As noted in I above, some California opinion givers, including many who support the "California" "essential provisions" interpretation, state separately a large number of express exceptions to the remedies opinion. Ironically, many of those who support the "each and every" interpretation use few exceptions. Yet, as described above under III,

⁵⁵ Details of this practice vary substantially from firm to firm. *See supra* note 36.

⁵⁶ This could be true even though the opinion giver successfully defends a liability claim on the basis that it complied with customary practice.

⁵⁷ *Supra* App. 4.

experienced opinion givers in general exercise the same customary practice (competence and legal diligence) in preparing and giving remedies opinions.

Why the difference in practice?

(1) Some contractual provisions raise special problems under California law.⁵⁸

Stated exceptions appropriately arising for this reason should be acceptable to opinion recipients. Appendix 10 analyzes and categorizes a list of “survey provisions,” providing guidance on whether separately stated exceptions are appropriate and customary as to those provisions. That appendix demonstrates that many of the exclusions from coverage of the remedies opinion found in the General Qualifications of the Accord or the California Qualifications of the 1992 Report need not be separately stated.⁵⁹

(2) Some California opinion givers believe that the possible application of the “each and every” interpretation of the remedies opinion compels more stated exceptions to reduce the risk of liability.

Stated exceptions are unnecessary for this reason, because liability for a breach of the duty of care is based primarily on the exercise of customary practice and not on whether the remedies opinion covers “each and every” provision.⁶⁰

(3) Some California opinion givers are less willing than their “New York” counterparts to leave out stated exceptions in reliance on customary usage.⁶¹

Customary usage⁶² assists in explaining the meaning of remedies opinions and related exceptions, and leads to the conclusion that certain issues are not covered by the opinion. In summary, an issue is not covered by the remedies opinion where, by customary usage, it is generally understood that the issue giving rise to the concern about enforceability (a) arises under a body of law that is not covered by the opinion,⁶³ (b) is

⁵⁸ For a discussion of the general similarity between the laws and courts of California and New York in enforcing contracts, *see infra* App. 9.

⁵⁹ *Infra* App. 10 Ann. A.

⁶⁰ *See supra* § III.

⁶¹ Historically, the extent of the willingness to accept customary usage to obviate the need for separately stated exceptions may have been the most important difference in approach between the TriBar Committee and the Section.

⁶² Certain words used in closing opinions are by customary practice generally understood to have special meanings. *See supra* App. 5 § III, including the discussion of why the debate over “each and every” vs. “essential provisions” is really a debate about customary usage. *See also 1998 TriBar Report* § 1.4 (b).

⁶³ *See supra* note 52; *infra* App. 10, at 12–15.

covered by the equitable principles limitation or bankruptcy exception,⁶⁴ or (c) is of a nature that opinion givers do not address, for example where the relevant undertaking is an economic remedy.⁶⁵ Many California opinion givers and others have moved substantially toward a consistent understanding of this customary usage.

The reader is encouraged to turn to Appendix 10 for more specific guidance on exceptions.

VI. SUMMARY AND CONCLUSION

With the benefit of more than a decade of experience since the Business Law Section's 1992 Report, it is now clear that national opinion practice has evolved to a point where the argument over "each and every" vs. "essential provisions" should no longer consume time and energy. Recovery from an opinion giver for breach of the duty of care to the opinion recipient in giving a remedies opinion will be based principally on whether the opinion giver has followed customary practice in preparing the opinion, not on a resolution of that argument. Customary competence and legal diligence do not vary significantly among opinion givers that regularly give legal opinions and adopt one or the other of these interpretations.

Since experienced opinion givers holding the different views tend to have the same competence and exercise the same legal diligence in preparing remedies opinions, the cost of giving opinions should not vary significantly. While reputational issues for an opinion giver may flow from rendering a flawed remedies opinion, this result has little to do with this dispute over the meaning and scope of the remedies opinion. Opinion recipients are and should be comfortable relying on remedies opinions rendered by competent lawyers using reasonable professional judgment while conducting customary diligence.

Some California opinion givers tend to state more exceptions to the remedies opinion than is generally found in the practice. While California remedies opinion practice will always vary to some extent from others,⁶⁶ some of the separately stated exceptions now found in some California opinions are superfluous.⁶⁷ It appears that California and other lawyers are increasingly willing to rely on generally understood

⁶⁴ See *infra* App. 10 § I.B.2.

⁶⁵ See *infra* App. 10 Ann. B § 3.

Of course, if the parties wish to avoid a separately stated exception, they may redraft a questionable contractual provision or restructure the transaction to avoid any uncertainty about enforceability.

⁶⁶ If for no other reason, because California has its own unique substantive legal issues.

⁶⁷ Moreover, the practice by a few opinion givers of including a laundry list of exceptions that do not refer or relate to any undertakings in the contract in question is unfortunate and inappropriate. It may suggest that the opinion preparers have not followed customary diligence by carefully reading the document. See *ABA Guidelines* § 1.3; Field, *One Size Doesn't Fit All*, 11 *Bus.Law Today* 5 (2002).

unstated limitations on the scope of the remedies opinion, and thereby to streamline opinions.

The Business Law Section continues its support of the trend toward a uniform national opinion practice and streamlined remedies opinions with fewer separately stated exceptions, where that is supported by customary usage.⁶⁸

⁶⁸ See *2001 Statement*, App. 3.

APPENDIX 9

REPORT OF THE ENFORCEABILITY SUBCOMMITTEE

I. CALIFORNIA ENFORCEABILITY ISSUES: ARE CALIFORNIA COURTS DIFFERENT?

One explanation for the historical difference of view between the TriBar Opinion Committee and the California State Bar Business Law Section about the meaning and scope of the remedies opinion (discussed in Appendix 8) is a perception that the law in California is significantly different from the law in other states (especially New York). Some have argued that California courts have an unusual tendency not to enforce contract provisions literally, when confronted with concerns about harsh or inequitable results. Proponents of this view claim that California courts are much quicker than others to apply such principles as an implied covenant of good faith and fair dealing and exceptions to the parol evidence rule in order to “do justice” in the face of contrary written contractual provisions. As a result, they argue that California courts are less inclined to give effect to the written words in agreements governed by California law, and thus that it is more difficult for California lawyers to give opinions that each and every written provision is enforceable in accordance with its terms.

II. ANALYTICAL APPROACH AND LIMITATIONS

The Opinions Committee did not have the time or resources to do an exhaustive comparison of California contract law and the behavior of California courts when enforcing contracts with the contract law and judicial behavior in the other 49 states. To make this undertaking manageable, we adopted the following more limited approach.

We compared California only with New York and not any other state. We selected New York because:

1. The TriBar Committee is the leading advocate of the “each and every” approach and it is based in New York.
2. New York has a well-developed body of contract law.
3. Many of our members practice in firms with offices in New York.
4. California transactions with significant New York contacts are sufficiently common that we have some threshold familiarity with New York law.
5. The common perception of New York contract law as applied by New York courts is the opposite of that of California. New York courts supposedly are “strict constructionists” -- ready, willing and able to enforce contracts as written, unaffected by the impulse to “do justice” that is said to infect California courts.

Therefore, we limited our comparative analysis to two states, California and New York. We needed to limit the scope of our analysis further, because we were not in a position to do a comprehensive comparison of all aspects of California and New York contract law. Instead, we focused only on certain key aspects of contract law, as described in the following section. In addition, we excluded consumer transactions from our review, because (1) consumer law contains many issues unique to the consumer context and (2) third-party legal opinions are rarely if ever given in consumer transactions. Also, although we have certain contacts with New York as noted above, most of us are not New York lawyers. It may also bear noting that we were

limited to reported cases, i.e., cases that resulted in appellate decisions; we were unable to research trial court decisions or settlements following adverse preliminary rulings.

These various limitations in our approach were appropriate, in light of the potential scope of the undertaking and the resources available to conduct it. Despite these limitations, hundreds of hours of effort were devoted to this undertaking.

In addition to legal research, we also conducted selected empirical investigations:

1. Discussions with experienced California and New York business litigators.
2. Comparisons of remedies opinions rendered by prominent California and New York law firms.

We believe the scope and quality of the investigation we undertook were sufficient to achieve our objective, namely, a testing of the common perception that a “continental divide” exists between California and New York with respect to the enforcement of contracts.

III. SUMMARY OF RESULTS -- AN “URBAN LEGEND” DISPELLED

Our findings did not support the common perception of a wide gap between California and New York in the enforcement of contracts. To the contrary, we generally found a high degree of consistency between California and New York in the enforcement of contracts.

In particular, we found a high degree of consistency between California and New York in the following areas:

1. The prima facie case required to establish the existence of an enforceable contract.¹
2. The existence of the implied covenant of good faith and fair dealing and the manner in which it is applied.²
3. The application of the concept of commercial reasonableness.³
4. The doctrine of unconscionability and the manner in which it is applied.⁴

¹ Nevills v. Moore Mining. Co., 135 Cal. 561 (1902); Justice v. Lang, 42 N.Y. 493 (1870).

² Both California and New York imply the covenant in contracts, as long as it does not contradict the express terms of a written contract. Third Story Music, Inc. v. Waits, 41 Cal. App. 4th 798 (1995); Weider v. Skala, 80 N.Y.2d 628 (1992); Prestige Foods v. Whale Sec. Co., L.P., 243 A.D.2d 281 (N.Y. Sup. Ct. 1997).

³ Both California and New York courts uphold contracts, even in the absence of certain terms, applying standards of reasonableness. Denver D. Darling, Inc. v. Controlled Env'ts Constr. Inc., 89 Cal. App. 4th 1221 (2001); Khoury v. Maly's of California, Inc., 14 Cal. App. 4th 612 (1993); Sutton v. E. River Sav. Bank, 55 N.Y.2d 550 (1982).

⁴ Dean Witter Reynolds, Inc. v. Superior Court, 211 Cal. App. 3d 758 (1989); Brower v. Gateway 2000, 246 A.D.2d 246 (N.Y. Sup. Ct. 1998).

5. The concept of materiality (including the requirement that a breach of contract be material before a remedy will be enforced) and the manner in which it is applied.⁵

6. The enforceability of oral modifications to a written contract.⁶

7. The enforceability of unwritten waivers (evidenced by either conduct or oral statements) of written provisions of a contract.⁷

8. The enforceability of *force majeure* provisions.⁸

9. Restriction against forfeitures.⁹

In sum, we found that the common perception that a wide gap exists between California and New York in their contract law and the willingness of their courts to enforce contracts as written is in the nature of an “urban legend,” i.e., the perception is not borne out by the evidence. In particular, the stereotype of California courts as unprincipled fora for the exercise of “barnyard equity,” and the contrary stereotype of New York courts as soulless automata enforcing the literal terms of contracts regardless of any other consideration, are just that -- stereotypes. The more mundane and complex reality is that the courts of both California and New York, in applying the laws of their states, show a similar strong proclivity to enforce contracts in accordance with their terms, subject to some important shared legal limitations.

IV. TWO IMMATERIAL EXCEPTIONS

We found two exceptions to the general conclusions summarized in the preceding section:

⁵ Both New York and California allow a remedy where one of the parties committed a material breach of the contract. *FPI Dev, Inc. v. Nakashima*, 231 Cal. App. 3d 367 (1991); *CT Chems., Inc. v. Vinmar Imprex, Inc.*, 81 N.Y.2d 174 (1993).

⁶ Oral modifications generally will be considered enforceable by New York courts unless an express term prohibits oral modification. *Turk v. Ariello*, 721 N.Y.S.2d 122 (N.Y. App. Div. 2001). However, even if the contract contains such a clause, an unwritten modification will be enforceable if it has been performed or if there has been conduct supporting claims of partial performance or detrimental reliance. *Rose v. Spa Realty Assoc.*, 42 N.Y.2d 338 (1977). Similarly, an unperformed oral modification to a written contract is only enforceable in California if it is supported by new bargained-for consideration, which consideration can include performance, or grounds for application of estoppel can be established. *Sanders Constr. Co., Inc. v. San Joaquin First Fed. Sav. & Loan Ass’n*, 136 Cal. App. 3d 387 (1982).

⁷ To be considered enforceable by either a New York or a California court, an unwritten waiver must be clearly intentional and evidenced either by conduct or by conduct and an oral agreement. *DRG v. Chopstix*, 30 Cal. 4th 54 (1994); *Squadron Boulevard Realty Co. v. Emrite, Inc.*, 99 Misc. 2d 975 (N.Y. Misc. 1979).

⁸ In both California and New York *force majeure* clauses excuse nonperformance when circumstances beyond the control of the parties prevent performance and the nonperformance was specifically contemplated by the *force majeure* clause. *Hariscom Svenska, AB v. Harris Corp.*, 3 F.3d 576 (2nd Cir. 1993); *Watson Lab., Inc. v. Rhone-Poulenc Rover, Inc.*, 178 F. Supp. 2d 1099 (D. Cal. 2001); *San Mateo Cmty. Coll. v. Half Moon Bay, L.P.*, 65 Cal. App. 4th 401 (1998).

⁹ Forfeiture clauses are disfavored in both California and New York. *Hawley v. Orange County Flood Control Dist.*, 211 Cal. App. 2d 708 (1963); *Birnbaum v. Rollerrama, Inc.*, 36 Misc. 2d 101 (N.Y. Misc. 1962).

1. The parol evidence rule is applied more strictly in New York than California. Neither state permits admission of extrinsic evidence to contradict the terms of an integrated contract. However, California is more open than New York to (a) considering whether a contract was integrated¹⁰ and (b) admitting extrinsic evidence to explain, clarify or supplement (but not contradict) the written terms of a contract.¹¹

2. New York's defense based on post-signing events rendering performance of a contract impossible or impractical is more limited than California's. California will excuse performance when the cost to perform becomes "excessive and unreasonable" and therefore performance is "impracticable."¹² New York will not excuse failure to perform just because performance becomes economically detrimental.¹³

While these two areas of divergence between California and New York law are noteworthy, neither is material in the context of third-party remedies opinions.

As to the parol evidence rule, the Business Laws Section's Corporations Committee stated in footnote 98 of its 1989 Report:

"[T]he possibility of parol evidence being introduced in order to aid in the interpretation of contract provisions, even if the result may be to frustrate one party's view of the proper interpretation of the contract language, is an implicit assumption in every remedies opinion and need not be expressly stated as an additional exception in the ever-growing 'laundry list' of opinion qualifications."

Given that California law with respect to parol evidence has not materially changed since 1989 and we concur with the 1989 Report's analysis of this point, we do not believe that any specific "parol evidence" exception needs to be included (though some lawyers include such an exception) in a remedies opinion in respect of a contract governed by California law. We believe the 1989 Report's conclusion on this point remains valid and is unaffected by the divergence between California and New York law with respect to the parol evidence rule.

As to the defense of impracticability, it is immaterial to remedies opinions for two reasons:

¹⁰ Compare *Banco do Brasil, S.A. v. Latian, Inc.*, 234 Cal. App. 3d 973 (1991), with *Mitchell v. Lath*, 247 N.Y. 377 (1928).

¹¹ See *Greenfield v. Philles Records, Inc.*, 98 N.Y.2d 562 (N.Y. 2002) (comparing California's and New York's approaches to the parol evidence rule). Compare *S. Pac. Transp. Co. v. Santa Fe Pac. Pipelines, Inc.*, 74 Cal. App. 4th 1232 (1st Dist. 1999) and *Esbensen v. Userware Int'l, Inc.*, 11 Cal. App. 4th 631 (4th Dist. 1992), with *Alexander & Alexander Servs. Inc. v. These Certain Underwriters at Lloyd's London*, 136 F.3d 82 (2nd Cir. 1998).

¹² *Mineral Park Land Co. v. Howard*, 172 Cal. 289, 293 (1916).

¹³ *407 East 61st Garage, Inc. v. Savoy Fifth Ave. Corp.*, 23 N.Y.2d 275, 281 (N.Y. 1968).

1. The defense arises out of courts' traditional equitable powers; consequently it is covered by the equitable principles limitation.¹⁴

2. The opinion giver is rendering an opinion as of its date based on the facts that exist at that time. The opinion giver is not responsible for taking into account post-closing conduct by the parties or other post-closing events unless the opinion giver has knowledge beforehand of the possibility of such post-closing events. The opinion giver is responsible for future facts and events that relate to performance subsequent to the date of the opinion letter only when the parties clearly contemplate that the facts and events will come into existence as a result of rights conferred or satisfaction of duties imposed by the contract. This is not the case for events that may give rise to a defense of impracticability.

Since the defense of impracticability is immaterial to remedies opinions, there is no need to modify opinion practice based on the divergence between California and New York law in this area.

V. CONCLUSION

Whatever other bases there may be for the historical difference between the "California" and "New York" views of the remedies opinion, we found no basis for this difference in our comparative review of California and New York contract law as currently applied by the courts of those states.

¹⁴ See Am. Bar Ass'n. Comm. on Legal Opinions, *Third-Party Legal Opinion Report, Including the Legal Opinion Accord of the Section of Business Law*, American Bar Association, 47 Bus. Law. 167, § 13(f) (1991); *infra* App. 10 Annex B n. 32 (application of the equitable principles limitation to contractual waivers of the defense of impracticability).

APPENDIX 10

EXCEPTIONS SUBCOMMITTEE REPORT

APPENDIX 10

EXCEPTIONS SUBCOMMITTEE REPORT

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APPENDIX 10

EXCEPTIONS SUBCOMMITTEE REPORT

I. PURPOSE

A. Limitations, Qualifications and Other Exceptions.

As discussed in Part VII of the Umbrella Report and in Appendix 8 at part V, opinion givers generally include limitations, qualifications, and other exceptions when rendering remedies opinions. These exceptions communicate to the opinion recipient that in the opinion giver's professional judgment there exists a level of uncertainty regarding the enforceability of one or more of the contractual provisions covered by the remedies opinion that prevents the opinion giver from reasonably concluding that the highest court of the applicable jurisdiction would enforce the provision.

The bankruptcy exception and the equitable principles limitation (each discussed in detail below) should be understood to be included in every remedies opinion, regardless of whether they are expressly stated. The Exceptions Subcommittee was formed to assess what exceptions to the remedies opinion, other than the bankruptcy exception and the equitable principles limitation, should, consistent with customary practice, be separately stated.

The Subcommittee identified, from a number of sources, the provisions ("Survey Provisions") to be evaluated for this purpose. The Third Party Legal Opinion Report (the "Accord") of the Section of Business Law of the American Bar Association ("ABA"), adopted in 1991, identified, at Section 14, a list of "Other Common Qualifications" that were considered not to be included within either the "Bankruptcy and Insolvency Exception"¹ ("bankruptcy exception") or the "Equitable Principles Limitation,"² but that should normally be accepted as qualifying remedies opinions where applicable.³ In May 1992, the Business Law Section of the

¹ Section 12 of the Accord.

² Section 13 of the Accord.

³ The Other Common Qualifications included generally applicable rules of law that:

a. limit or affect the enforcement of provisions of a contract that purport to require waiver of the obligations of good faith, fair dealing, diligence and reasonableness;

b. provide that forum selection clauses in contracts are not necessarily binding on the court(s) in the forum selected [included within, but slightly narrower than, California Qualification No. 9];

c. limit the availability of a remedy under certain circumstances where another remedy has been elected;

d. limit the right of a creditor to use force or cause a breach of the peace in enforcing rights;

e. relate to the sale or disposition of collateral or the requirements of a commercially reasonable sale [probably subsumed within California Qualification No. 6];

State Bar of California published its “Report on the Third-Party Legal Opinion Report of the ABA Section of Business Law” (the “1992 Report”), “to provide guidance to members of the California bar who wish to adopt the Accord for third-party opinions rendered under California law.” The 1992 Report set forth additional “California Qualifications”—“contractual provisions not fully covered by the Accord’s exclusions that should not be automatically covered by an opinion because there could be a significant question as to the enforceability of the provision.”⁴

f. limit the enforceability of provisions releasing, exculpating or exempting a party from, or requiring indemnification of a party for, liability for its own action or inaction, to the extent the action or inaction involves gross negligence, recklessness, willful misconduct or unlawful conduct;

g. may, where less than all of a contract may be enforceable, limit the enforceability of the balance of the contract to circumstances in which the unenforceable portion is not an essential part of the agreed exchange;

h. govern and afford judicial discretion regarding the determination of damages and entitlement to attorneys’ fees and other costs;

i. may, in the absence of a waiver or consent, discharge a guarantor to the extent that (i) action by a creditor impairs the value of collateral securing guaranteed debt to the detriment of the guarantor, or (ii) guaranteed debt is materially modified; and

j. may permit a party who has materially failed to render or offer performance required by the contract to cure that failure unless (i) permitting a cure would unreasonably hinder the aggrieved party from making substitute arrangements for performance, or (ii) it was important in the circumstances to the aggrieved party that performance occur by the date stated in the contract.

k.

⁴ The California Qualifications encompassed:

1. Choice-of-law provisions.
2. Covenants not to compete.
3. Provisions for penalties, liquidated damages, acceleration of future amounts due (other than principal) without appropriate discount to present value, late charges, prepayment charges, and increased interest rates upon default).
4. Time is of the essence clauses.
5. Confession of judgment clauses.
6. Provisions that contain a waiver of (i) broadly or vaguely stated rights, (ii) the benefits of statutory, regulatory, or constitutional rights, unless and to the extent that the statute, regulation, or constitution explicitly allows waiver, (iii) unknown future defenses, and (iv) rights to damages.
7. Provisions that attempt to change or waive rules of evidence or fix the method or quantum of proof to be applied in litigation or other proceedings.
8. Provisions that provide for the appointment of a receiver.

Lastly, responses to a survey conducted by the Opinions Committee’s predecessor, the Opinion Task Force, in 2001 (the “2001 Survey”), identified additional provisions that one or more respondents considered of questionable enforceability.⁵ A complete list of the Survey Provisions is attached as part of **Annex A**.⁶

B. Defining the Bankruptcy and Equitable Principles Exceptions.

The Subcommittee determined, after discussion with a broad group of practitioners, that understanding the scope of the two universally accepted standard exceptions (bankruptcy and equitable principles)—*i.e.*, understanding what they are properly understood to encompass as a matter of customary usage—might assist in determining whether one or more of the Survey Provisions should be separately stated in opinion letters. A brief description of those two exceptions follows:

1. Bankruptcy Exception.

a. Common formulations of the bankruptcy exception include:

1989 Opinions Report of the Corporations Committee of the California State Bar’s Business Law Section (“1989 Report”):

The [enforceability of the agreement] may be subject to or limited by bankruptcy, insolvency, reorganization, arrangement, moratorium or other similar laws relating to or affecting the rights of creditors.

-
9. Forum selection clauses and consent to jurisdiction clauses (both as to personal and subject matter jurisdiction).
 10. Provisions appointing one party as attorney-in-fact for an adverse party.

There is some overlap between the California Qualifications and the Other Common Qualifications; the Subcommittee adjusted for that overlap in preparing this appendix.

⁵ The form of the survey is included as Appendix 6 to the Umbrella Report. The “Survey Provisions” include the limitations on enforceability described in paragraphs (e) and (f) of the Accord’s Equitable Principles Limitations (Survey Provisions No. 31 and 32, respectively). This is because, while the drafters of the California Qualifications accepted all of the Accord’s Equitable Principles Limitations as limitations on the enforceability of contracts that are based on “equitable principles,” they did so on the basis that those limitations had been agreed to as part of the process of negotiating the Accord, not because the drafters of the California Qualifications had independently determined that all of the limitations included in the Accord’s list properly fell within the purview of “equitable principles.” The members of the Subcommittee believe there to be enough question concerning limitations (e) and (f) to merit their inclusion as “Survey Provisions” for purposes of this appendix.

⁶ The remedies opinion is, by customary practice, rendered only with respect to laws of general application—in the words of the 1998 TriBar Report, “laws that lawyers who render legal opinions of the type involved would reasonably recognize as being applicable (i) to transactions of the type covered by the agreement and (ii) to the role of the [opinion giver’s client] (but not other parties to the agreement) in the transaction.” 1998 TriBar Report § 3.5.1. (See *infra* “Further Note,” as well as Appendix 8, at n. 50 and accompanying text.)

⁷ As of September 2004, the Corporations Committee of the Section is preparing a report that revises and restates the 1989 Report. The new report, however, will not address remedies opinions except by reference to the Umbrella Report and its appendices, which collectively supersede the relevant portions of the 1989 Report.

Accord:

[The Remedies Opinion] is subject to the effect of bankruptcy, insolvency, reorganization, receivership, moratorium and other similar laws affecting the rights and remedies of creditors generally.”

“Third-Party ‘Closing’ Opinions,” A Report of The Tri-Bar Opinion Committee (“1998 TriBar Report”)⁸:

Our opinions above are subject to bankruptcy, insolvency and other similar laws affecting the rights and remedies of creditors generally . . .

b. Scope of bankruptcy exception.

1989 Report: The 1989 Report did not go into great detail regarding the scope of the bankruptcy exception, but did express the view that it encompasses questions of fraudulent transfer, equitable subordination and other similar concerns.⁹

Accord: Section 12 of the Accord set forth its drafters’ understanding that the bankruptcy exception applicable to an opinion that has adopted the Accord includes:

- (a) the Federal Bankruptcy Code and thus comprehends, among others, matters of turn-over, automatic stay, avoiding powers, fraudulent transfer, preference, discharge, conversion of a non-recourse obligation into a recourse claim, limitations on *ipso-facto* and anti-assignment clauses and the coverage of pre-petition security agreements applicable to property acquired after a petition is filed;
- (b) all other Federal and state bankruptcy, insolvency, reorganization, receivership, moratorium, arrangement and assignment for the benefit of creditors laws that affect the rights and remedies of creditors generally (not just creditors of specific types of debtors);

⁸ 53 Bus. Law. 591 (1998). The 1998 TriBar Report also notes that the bankruptcy exception and equitable principles limitation are “sometimes stated as being generally applicable to all opinions,” rather than just to the remedies opinion, and the Illustrative Opinion Letters included in the 1998 TriBar Report take that approach.

⁹ 1989 Report, ¶ V.C.1.

- (c) all other Federal bankruptcy, insolvency, reorganization, receivership, moratorium, arrangement and assignment for the benefit of creditors laws that have reference to or affect generally only creditors of specific types of debtors and state laws of like character affecting generally only creditors of financial institutions and insurance companies;
- (d) state fraudulent transfer and conveyance laws; and
- (e) judicially developed doctrines relevant to any of the foregoing laws, such as substantive consolidation of entities.

The bankruptcy exception, as viewed by the Accord, does not include laws affecting creditors generally but that are not similar to the listed laws—for example, the UCC or usury laws. Under the Accord, if a provision of the UCC affects the enforceability of a provision as written, that provision should be specifically identified and excepted from the opinion, unless covered by the equitable principles limitation or otherwise not covered by the opinion.

1998 TriBar Report: According to the 1998 TriBar Report, the bankruptcy exception “is more aptly an ‘insolvency law exception’ in that it covers not only the federal Bankruptcy Code but also any other similar insolvency laws (state or federal) of general application.”¹⁰ Moratorium, fraudulent transfer and conveyance, and reorganization laws are included; usury laws (because they are not similar to insolvency laws) are not.¹¹ State insolvency laws relating to financial institutions or insurance companies as debtors should be understood to be covered by the bankruptcy exception, but state laws relating to the insolvencies of other types of entities, because they are not likely to be widely known, should not.¹²

¹⁰ 1998 TriBar Report, § 3.3.2.

¹¹ *Id.* The 1998 TriBar Report, at § 3.3.2, n. 75, expresses the view of the TriBar Committee that, while “the use of the word ‘similar’ makes clear that the exception does not comprehend those laws that affect creditors’ rights generally but are unrelated to laws grounded in insolvency,” such as usury laws (*see* n.11, *supra*), “omission of the word ‘similar’ [as in the case cited above] should not be construed to broaden the scope of the exception: clearer language is required to do that.”

The Subcommittee concurs with the view, expressed in the Accord and the 1998 TriBar Report, that the remedies opinion should be understood to cover usury law issues generally, and that a California remedies opinion includes an opinion to the effect that the interest rate stated in the agreement to apply to any loan or forbearance of money does not violate applicable provisions of California usury law. Nevertheless, an out-of-state lender who is unfamiliar with California’s usury law regime may request that an opinion giver render a separately articulated opinion addressing the absence of any violation of that regime; and it is not uncommon for California opinion givers to render such an opinion.

Provisions relating to permissible interest rates with respect to loans or forbearances of money are not included among the Survey Provisions. This is due partly to historical reasons—California opinion givers have customarily dealt with California’s Byzantine set of exemptions from its usury laws by assuming that the lender(s) qualified for one or more exemptions—and partly to the enactment in 2000 of California Corporations Code § 25118, which provides an exemption, available even to many non-regulated lenders, with respect to commercial loans (i) made to borrowers (or guaranteed by affiliates) having at least \$2,000,000 in assets, or (ii) of at least \$300,000, for which no

Case law: The Subcommittee found a single case addressing the scope of the bankruptcy exception: *In re Kar Development Associates, L.P.*¹³ In that case, the court found that an opinion to the effect that a document (purporting to be a lease of a hotel) was enforceable in accordance with its terms, “except as enforcement thereof may be limited by bankruptcy, insolvency or other laws affecting the enforcement of creditors’ rights,” did not provide assurance that the lease constituted a true lease that would not be recharacterized as a mortgage in a bankruptcy proceeding involving the purported lessee.¹⁴

c. Conclusion.

The Subcommittee believes that the interpretations of the scope of the bankruptcy exception expressed in the 1989 Report, the Accord, and the 1998 TriBar Report are equivalent in all material respects and that no difference in scope should be inferred from the differences among their formulations of that exception.

2. Equitable Principles Limitation.

a. Common formulations of the equitable principles limitation include:

1989 Report: The 1989 Report considered this formulation to be traditional:

The enforceability of the Company’s obligations under the agreement is subject to general principles of equity [including the possible

individual (as principal obligor, as general partner or as guarantor) is responsible. The statute requires that lender and borrower (or their principals) either have a pre-existing personal or business relationship or, by reason of their own business and financial experience or that of their professional advisers, could reasonably be assumed to have the capacity to protect their own interests in connection with the transaction; the Subcommittee believes that, if an opinion giver is not sure whether the statutory condition is satisfied, the opinion giver should include an appropriate assumption with respect to the existence of a qualifying relationship or the possession, by the parties or their professional advisers, of qualifying business and financial experience. (Section 25118 does *not*, however, exempt lenders from compliance with any requirement that they be licensed under California law.)

¹² 1998 TriBar Report, § 3.3.3.

¹³ 180 B.R. 597 (Bankr. D. Kan. 1994).

¹⁴ *Id.* at 619. The Subcommittee believes, however, that whether a lease will be recharacterized as a mortgage or security agreement is actually governed by principles of law that are *not* included within the bankruptcy exception, as that exception is described in any of the 1989 Report, the Accord, and the 1998 TriBar Report. A remedies opinion simply does not include any opinion on the characterization of a “lease” as a “true lease” (or any other characterization), and does not need an express exclusion to that effect. *See, e.g.*, N.Y. TriBar Opinion Comm., “Special Report of The TriBar Opinion Committee: U.C.C. Security Interest Opinions – Revised Article 9”, 58 Bus. Law 1449 (2003), at Appendix C (noting that a remedies opinion does not address whether or not an agreement creates a security interest). *See also* Appendix 4, at n. 22.

unavailability of specific performance or injunctive relief]¹⁵, regardless of whether considered in a proceeding in equity or at law.

It recommended, however, that the traditional wording be modified to read as follows (added language bolded):

The enforceability of the Company's obligations under the agreement is subject to general principles of equity, **including without limitation concepts of materiality, reasonableness, good faith and fair dealing** [and the possible unavailability of specific performance or injunctive relief], regardless of whether considered in a proceeding in equity or at law.

Accord:

[The Remedies Opinion] is subject to the effect of general principles of equity, whether applied in a court of law or equity.

1998 TriBar Report:

Our opinions above are subject to . . . general principles of equity.

b. Scope of equitable principles limitation.

1989 Report: The 1989 Report expressed the view that the equitable principles limitation addresses:

- the possibility that one or more provisions of an agreement might not be specifically enforced, or that injunctive relief might not be granted;
- traditional equitable defenses, such as waiver, estoppel or laches;
- court decisions holding some loan provisions “to violate public policies rendering the provisions unenforceable unless they are demonstrated under the circumstances to be reasonably necessary for the lender’s protection”; and
- the “effect of the implied covenant of good faith and fair dealing that is embodied in every contract under California law.”¹⁶

The 1989 Report also expressed the view that the equitable principles limitation *includes*:

¹⁵ The exception “encompasses both specific performance and injunctive or other relief, whether or not the specific bracketed reference is used.” 1989 Report at ¶ V.C.1.

¹⁶ 1989 Report, ¶ V.C.1.

the effect of California Civil Code Section 1670.5, which permits a court that, as a matter of law, finds a contract or any clause of a contract to have been unconscionable at the time it was made, to refuse to enforce the contract, to enforce the remainder of the contract without the unconscionable clause, or to limit the application of the unconscionable clause so as to avoid any unconscionable result.

Accord: Section 13 of the Accord reflected its drafters' agreement that the equitable principles limitation applicable to an opinion that has adopted the Accord includes principles:

- (a) governing the availability of specific performance, injunctive relief or other equitable remedies, which generally place the award of such remedies, subject to certain guidelines, in the discretion of the court to which application for such relief is made;
- (b) affording equitable defenses (*e.g.*, waiver, laches and estoppel) against a party seeking enforcement;
- (c) requiring good faith and fair dealing in the performance and enforcement of a contract by the party seeking its enforcement;
- (d) requiring reasonableness in the performance and enforcement of an agreement by the party seeking enforcement of the contract;
- (e) requiring consideration of the materiality of (i) the Client's breach and (ii) the consequences of the breach to the party seeking enforcement;
- (f) requiring consideration of the impracticability or impossibility of performance at the time of attempted enforcement; and
- (g) affording defenses based upon the unconscionability of the enforcing party's conduct after the parties have entered into the contract.

1998 TriBar Report: The 1998 TriBar Report does not attempt a precise definition of the equitable principles limitation, noting that "courts have an interest in justice (as well as predictability) and concepts relating to fair dealing provide broad discretion."¹⁷ It notes, however, that the limitation does cover "the availability of traditional equitable remedies (such as specific performance or injunctive relief)", and "defenses rooted in equity that result from the enforcing party's lack of good faith and fair dealing, unreasonableness of conduct [including concepts such as coercion, duress, unconscionability, undue influence, and, "in some cases," estoppel] or undue delay (*e.g.*, laches)."¹⁸

¹⁷ 1998 TriBar Report, § 3.3.4.

¹⁸ *Id.* and n. 78.

In contrast to the 1989 Report, which viewed the equitable principles limitation as including unconscionability existing at the time an agreement is made, the 1998 TriBar Report states its view that, “[i]f before rendering the remedies opinion the opinion preparers believe that coercion, duress or similar inequitable conduct has prevented the formation of the agreement in question, they should not render the opinion (or should disclose their concerns, if the client consents). Unless they have knowledge to the contrary, the opinion preparers are entitled to assume [without so stating] the absence of conduct so egregious as to preclude formation of an agreement . . .”¹⁹

c. Conclusion.

The Subcommittee, like the TriBar Committee, recognizes the broad discretion accorded to courts in the interest of doing justice, and endorses the 1998 TriBar Report’s approach to the equitable principles limitation—including (for the reasons described below, in endnote 28) the TriBar Committee’s conclusion that the limitation should apply, with respect to unconscionability, only to unconscionable conduct that occurs after an agreement has been formed.²⁰

The Subcommittee further endorses, and adopts for purposes of this appendix, the understanding, first expressed in the 1992 Report, that the equitable principles limitation encompasses (in addition to judicially developed rules) statutes, rules and regulations that codify traditionally recognized equitable principles.²¹

The Subcommittee believes that no difference in the scope of the equitable principles limitation should be inferred from any particular formulation of that limitation—*i.e.*, that a limitation stating simply that “Our opinions above are subject to general principles of equity” should be understood to be equivalent to one that adds “including without limitation concepts of materiality, reasonableness, good faith and fair dealing and the possible

¹⁹ *Id.* at n. 77. The 1987 report by the Joint Committee of the Real Property Law Section of the State Bar of California and the Real Property Section of the Los Angeles County Bar Association on Legal Opinions in Real Estate Transactions (the “1987 Real Property Report”) took the same view: “. . . the Joint Committee believes that the unconscionability issue should not be deemed to be included in the generic qualification set forth above and that a lawyer should not be permitted to include unconscionability as a qualification to the enforceability opinion unless the lawyer identifies the particular provision that he or she believes to be unconscionable.” *Id.*, 42 Bus. Law. 1167. While the quoted language technically addressed the scope of the generic exception, it would not be necessary had the drafters of the report concluded that unconscionability was encompassed by the equitable principles limitation.

²⁰ Similarly, reasonableness and good faith apply to conduct by the enforcing party after the formation of the contract.

²¹ Thus, for example, the 1992 California Report did not recommend that an express exception be taken for provisions that purport to require waivers and amendments to be in writing; Civ. Code § 1698, which provides that certain oral amendments will be given effect, was best viewed as a codification of the traditional equitable principle that gives effect to oral amendments that have been fully executed. 1992 California Report, § III.F.

unavailability of specific performance or injunctive relief, regardless of whether considered in a proceeding in equity or at law.”

II. ANALYSIS OF SURVEY PROVISIONS

In assessing whether the Survey Provisions should customarily be addressed by separately stated exceptions to the remedies opinion, the Subcommittee considered only California case law and California statutes and regulations. The standard against which the Subcommittee assessed enforceability was *not* absolute assurance of enforcement in all conceivable circumstances. Few, if any, contractual provisions could meet that standard. Instead, the Subcommittee focused on whether there existed, independently of the circumstances in which enforcement of a Survey Provision might be sought, a significant degree of uncertainty as to the enforceability of that Survey Provision. Where the Subcommittee concluded that there did exist such a significant degree of uncertainty, the Subcommittee considered whether in all circumstances the Survey Provision should be separately called out in the opinion, or whether a basis exists for suggesting that a separate exception with respect to that Survey Provision is unnecessary. For example, a separate exception may not be necessary because the reasons for which a court might refuse to enforce the Survey Provision as written are equitable in nature (and therefore included in the equitable principles limitation) or are otherwise beyond the scope of the opinion.²²

The Subcommittee classified each Survey Provision into one of the following four categories:

1. **“Equitable Principles Limitation”:** The Survey Provision generally is not enforceable as written. No separate exception is necessary, however, because, as a matter of customary usage, the equitable principles limitation is understood to include the principal basis that would cause the Survey Provision not to be enforceable.²³
2. **“Generally Enforceable”:** The Survey Provision is generally enforceable.²⁴ Consequently, a separate exception is not necessary and should not be taken.

²² E.g., because they (i) arise under a body of law that is generally understood not to be covered by the opinion (*see, e.g., infra*, “Further Notes”), (ii) are generally understood to be covered by the bankruptcy exception, or (iii) encompass an issue that opinion gives customarily do not address, as in the case of certain of the economic remedies referred to in Survey Provision No. 3. *See also* Umbrella Report at ¶ V; Appendix 8 at ¶ V(3). As will be noted from the categories included in this appendix, the Subcommittee also determined that some of the Survey Provisions need not be made the subject of a separate exception in all circumstances, but only where enforcement of the provision, as drafted, would not be permitted under the governing statute, regulation or legal principles. Unless the context otherwise requires, further references in this appendix to “statutes” or to “statutory” limitations or the like include regulations and regulatory limitations.

²³ The reasons for which the Survey Provision is not enforceable do not depend upon the circumstances in which enforcement is sought. The Survey Provision, if given effect, would negate the application of a mandatory equitable principle—for example, it purports to permit a party to act in bad faith.

²⁴ The Survey Provision, as written, is generally enforceable. Circumstances might arise after the agreement becomes effective, however, that would prevent the Survey Provision from being enforced as written. One such circumstance--the subsequent bankruptcy of the obligor--is covered by the bankruptcy exception. Other such

3. **“Exception Sometimes Required”**: There may be limited circumstances in which courts will not enforce the Survey Provision as written; but only if those circumstances are present is it appropriate to take a separate exception.²⁵
4. **“Exception Usually Required”**: The Survey Provision is generally unenforceable and is not within category 1 above. An exception, if deemed to be appropriate under the circumstances, should be separately stated.²⁶

III. CONCLUSIONS

The table set forth below, together with Annex A, indicates the Subcommittee’s conclusions regarding each of the Survey Provisions. **These tables are intended to assist opinion preparers in considering the enforceability of provisions that are commonly included in contracts, however, and not as a substitute for careful consideration. In general, opinion preparers should read the entire agreement and consider the proper characterization of its provisions in light of the language and structure of the agreement and the transaction to which it relates.**²⁷

circumstances might make it inequitable to enforce the Survey Provision as written—for example, by reason of laches. Unenforceability for this reason is covered by the equitable principles limitation. (N.B.: “Generally Enforceable”, in this context, also does not address reasons for which the Survey Provision might not be enforced that are beyond the scope of the opinion. See, e.g., *infra*, “Law Covered by Remedies Opinion”, under “Further Notes.”)

²⁵ Although the Survey Provision is often enforceable, there exist circumstances under which a court might refuse to enforce the Survey Provision for reasons that, as a matter of customary usage, are understood *not* to be encompassed by either the bankruptcy exception or the equitable principles limitation, and, if an exception is believed to be appropriate under the circumstances, it should be separately stated. This does not mean that, in all cases, the inclusion of the Survey Provision in an agreement that is being opined upon should result in an exception being taken with respect to the Survey Provision.

²⁶ The Survey Provision is generally unenforceable for reasons that, as a matter of customary usage, are understood *not* to be encompassed by either the bankruptcy exception or the equitable principles limitation, and not to be beyond the scope of the opinion. (For example, a provision that provides for a lender to recover its attorneys’ fees and expenses of litigation, regardless of whether it is the prevailing party, would not be enforceable under Cal. Civ. Code § 1717 (*see infra* endnote 21), and it would be appropriate to include an exception regarding the enforceability of that provision.)

²⁷ The Subcommittee decided that, for purposes of its report, it would base its recommendations primarily on an unsecured commercial loan paradigm. In the experience of its members, remedies opinions are rarely requested in the consumer context. The Subcommittee also considered, however, certain other provisions (for example, covenants not to compete) that are generally not implicated by loan transactions but which must often be considered by opinion givers in other contexts. The Subcommittee anticipates that the UCC Committee of the Section and the Real Property Law Section of the California State Bar will address exceptions to the remedies opinion that are peculiar to transactions secured by personal or real property, respectively.

AT-A GLANCE: CLASSIFICATION OF EXEMPTIONS ²⁸

Classification:	Equitable Principles Limitation	Generally Enforceable	Exception Sometimes Required	Exception Usually Required
Survey Provisions Included in Classification:	Waivers of obligations of good faith and fair dealing (10)	Choice of law (1)	Remedies cumulative (16)	Covenants not to compete (2)
		Time is of the essence (4)	Arbitration provisions (20)	Provisions for penalties, etc. (3)
	Waivers of rights to cure (where harm not material) (19)	Forum selection/ consents to jurisdiction (13)	Indemnities/releases (23)	Confessions of judgment (5)
	Exercise of remedies without consideration of materiality of breach, consequences of breach (31)	Appointment of attorney-in-fact (14)	Unconscionable provisions (28)	Waivers of (i) broadly or vaguely stated rights (6); (ii) statutory, regulatory, or constitutional rights, except as permitted (7); (iii) unknown future defenses (8); or (iv) damages (9)
		Severability (17)	Waivers of statutes of limitation (30)	Changes/waivers of rules of evidence, etc. (11)
	Exercise of remedies without considering impracticability or impossibility due to unforeseen circumstances (32)	Prohibition of oral modifications (22)		Appointment of receiver (12)
		Self-help remedy provisions (24) ²⁹		Waivers of jury trials (15)
		Rights of setoff (27)		Waivers of guarantor's defenses (18)
		Payments free of setoff, counterclaims, etc. (29)		Attorneys' fees to one party only (21)
				Indemnification for securities law liabilities (25)

As a general matter, the Subcommittee has attempted to *reflect* relevant statutory and case law and the customary practice of California opinion preparers and givers, and not to *prescribe* what practice should be. Where what has been customary practice appears no longer to be supported by developments in statutory or case law, however--as is the case, for example, with respect to choice-of-law provisions--the Subcommittee has recommended that customary practice evolve to reflect those developments.

²⁸ Voting agreements (26) are not classified.

²⁹ But see endnote 24 with respect to purported authorizations of breaches of the peace.

FURTHER NOTES:

Limited Universe: The Survey Provisions do not constitute an exhaustive list of provisions that can present enforceability issues in the context of a remedies opinion. Certain transactions—for example, mergers—present issues regarding the enforceability of other types of provisions, such as provisions requiring the payment of break-up fees if the transaction is not consummated.

Law Covered by Remedies Opinion: “Law” means statutory, decisional, and regulatory law at the state or federal (but not the local) level. As noted in the 1998 TriBar Report (and consistent with the Accord), a remedies opinion is customarily understood *not* to address the following areas of law³⁰:

1. Local law is not covered:
 - Thus, an opinion should not be read to cover matters such as local zoning or building codes unless it does so expressly.” 1998 TriBar Report § 1.9(n).³¹
 - “Local Law”, excluded from an opinion under Section 19 of the Accord unless explicitly addressed in an opinion letter, means “the statutes and ordinances, the administrative decisions, and the rules and regulations of counties, towns, municipalities and special political subdivisions (whether created or enabled through legislative action at the Federal, state or regional level—*e.g.*, water agencies, joint power districts, the Maine Turnpike Authority, The Southern California Rapid Transit District, the Port Authority of New York and New Jersey), and judicial decisions to the extent that they deal with any of the foregoing.” Accord, Glossary.
2. Certain areas of law are not covered unless specifically addressed:
 - a. 1998 TriBar Report.
 - Regulatory issues involving other parties to the agreement (*e.g.*, for an opinion by counsel to a borrower, whether a loan would violate the lender’s lending limit).
 - Tax laws.
 - Insolvency laws.³²

³⁰ See also Appendix 8, at n. 50 and accompanying text, with respect to what law an opinion does cover. Unless otherwise indicated, references in this appendix to the “laws” of a particular authority include regulations promulgated thereunder.

³¹ In addition, the 1998 TriBar Report advises that “[i]f an opinion does not state that it covers federal law, . . . that law is understood not to be covered unless the context indicates otherwise.” 1998 TriBar Report § 4.1.

- Antitrust laws.
- Securities laws (except for the Investment Company Act, if the opinion giver's client is a registered investment company, or where the opinion giver recognizes that a company's activities may make it an inadvertent investment company).
- The Exon-Florio amendment.³³

b. Accord (Section 19).

- Federal securities laws and regulations administered by the SEC (other than the Public Utility Holding Company Act of 1935 [as it affects the opinion giver's client]), state "Blue Sky" laws and regulations, and laws and regulations relating to commodity (and other) futures and indices and other similar instruments.
- Federal Reserve Board margin regulations.³⁴
- ERISA and other pension and employee benefit laws and regulations.
- Hart-Scott-Rodino (antitrust laws) and Exon-Florio.
- Compliance with fiduciary duty requirements.³⁵
- The characterization of a transaction as one involving the creation of a lien or a security interest, as one in a form sufficient to create a lien or security interest, and the creation, attachment, perfection, priority or enforcement of a lien or security interest.
- Fraudulent transfer and fraudulent conveyance laws.³⁶

³² Note that insolvency laws are automatically excluded by the bankruptcy exception, in any event.

³³ 1998 TriBar Report § 3.5.2.

³⁴ The 1998 TriBar Report thought it "unclear" whether Federal margin regulations are covered unless specifically mentioned, and recommended that an opinion recipient who wanted the issue covered ask that it be expressly addressed. 1998 TriBar Report § 3.5.2. The Accord approach is consistent with the understanding of most members of the Subcommittee.

³⁵ The 1998 TriBar Report reaches the same result by taking the view that an assumption to the effect that "those who have approved an agreement have satisfied their fiduciary obligations and have disclosed any interest" is *understood to be applicable whether or not stated*, on the ground that the issue is one of fact that is "common to transactions generally and [is] customarily assumed as a matter of course." 1998 TriBar Report §§ 2.3(a)), 3.5.2(b).

- Environmental laws.
- Land use and subdivision laws.
- Tax laws.
- Intellectual property laws.
- RICO and other racketeering laws.
- OSHA and other health and safety laws.
- Labor laws.
- Laws relating to national and local emergency, possible judicial deference to acts of sovereign states, and criminal and civil forfeiture laws.
- Other criminal statutes of general application.

The 1992 Report, in concluding that use of the Accord by members of the California Bar would “be generally appropriate,” did not expand upon Section 19. The Subcommittee believes that California lawyers customarily do not expect that laws described in Section 19 of the Accord are addressed by a legal opinion, absent specific mention.

Use of Assumptions to Close Gaps: In addition, certain issues relating to the enforceability of agreements are customarily dealt with by assumptions taken by the opinion giver. *See*, for example, Section 4 of the Accord, “Reliance by Opinion Giver on Assumptions,” to the effect that an opinion giver may rely upon the several assumptions set forth in that Section “unless in a given case the particular assumption states, directly or in practical effect, a legal conclusion expressed in the [o]pinion.”³⁷

³⁶ By customary usage, fraudulent transfer laws are understood to be excluded by virtue of the bankruptcy exception, in any event.

³⁷ Such issues as compliance by other parties to the transaction with legal requirements applicable to them, to the extent necessary to make the agreements being opined upon enforceable against them, compliance by the parties to the transaction with the terms of the agreements being opined upon, etc., are commonly dealt with by assuming the relevant facts, rather than by qualifying the remedies opinion (*e.g.*, “[w]e express no opinion regarding the compliance by the lender with any legal requirements applicable to lender by reason of its being engaged in the business of making loans”). As noted in the text, the Subcommittee concurs with the view that these specific assumptions are customarily understood to apply to a remedies opinion, whether or not they are separately stated. *Cf.* Paragraphs 2.3 (Use of Opinions as Fact Substitutes) and 2.5 (Officers’ and Other Certificates) of the 1998 TriBar Report. While such matters are beyond the scope of this appendix, the Subcommittee notes that, in the experience of its members, the assumptions listed in Section 4 of the Accord are customarily understood by opinion recipients to apply, whether or not expressly stated. *See also* The TriBar Opinion Committee, “The Remedies Opinion -- Deciding When To Include Exceptions And Assumptions,” 59 Bus. Law. 1483 (2004) (the “TriBar Remedies Opinion Report”) at Part II.

Assumptions, however, must be reliable. An opinion giver may not rely on an unstated assumption that is unreliable. Thus, for example, an opinion giver who is aware of the existence of coercion or duress in the formation of a contract, or of facts that give rise to an inference that coercion or duress may exist, may not rely on an implicit assumption of their absence for purposes of rendering a remedies opinion.³⁸ Nor may an opinion giver rely upon a stated assumption if the opinion giver is aware of facts that give rise to an inference that the assumption is not true--*i.e.*, a stated assumption may be used to bridge a gap in the opinion giver's knowledge of the facts that need to be established to support a legal opinion, but only where it is not misleading, to do so.³⁹

FINAL ADMONITION:

Opinions must not be misleading: If, under the circumstances of a given transaction, an opinion giver believes that an opinion would be misleading to the recipient were the opinion giver (in reliance upon customary practice or otherwise) to leave unstated an exception that this appendix concludes it is not necessary to state, the opinion giver should consider making an appropriate disclosure, so as to avoid rendering a misleading opinion.

³⁸ See the discussion of unconscionability, *infra*, at endnote 28.

³⁹ Cf. Paragraph 2.3(c) of the 1998 TriBar Report (“Opinion preparers should not rely on an unstated assumption if it is unreliable. . . . “By way of contrast, stated assumptions, like opinion exceptions, put the opinion recipient on notice that the opinion preparers have not established the facts being assumed. . . . [and] shift to the opinion recipient the responsibility for confirming the assumed facts for itself or taking the risk that what is assumed might turn out to be untrue.”). As the TriBar Committee further notes, it is inappropriate to rely on a stated assumption if doing so would result in the rendering of a misleading opinion. See also the caution against the rendering of a misleading opinion, *infra*, in “Final Admonition.”

ANNEX A CHARTS

The following charts summarize the Subcommittee’s conclusions, on a Survey Provision-by-Survey Provision basis, followed by a set of samples of language for exceptions with respect to provisions that are classified as either Exception Sometimes Required or Exception Usually Required. Please consult the “Discussion” section in Annex B, immediately following this Annex A, for a more complete discussion of the Subcommittee’s reasoning.

GENERAL

Survey Provision	Classification
1. Choice-of-law provisions.	<ul style="list-style-type: none"> Outbound (choice of law other than California): Generally Enforceable (Such provisions are generally enforceable, unless there is no connection to the chosen-law state. Where there is such a connection, the opinion giver may choose to note that enforceability may be affected by considerations of the fundamental policies of states other than the chosen law state, an issue that is in any event beyond the scope of the opinion.) Inbound (choice of California law): Generally Enforceable (Such provisions are generally enforceable if the transaction involves \$250,000 or more; if it does not, the “outbound” rule applies)
2. Covenants not to compete.	Exception Usually Required (The enforceability of such covenants may be limited by applicable statutory provisions.)
3. Provisions for penalties, liquidated damages, acceleration of future amounts due (other than principal) without appropriate discount to present value, late charges, prepayment charges, or increased interest rates upon default.	Exception Usually Required (Generally, such provisions are subject to a test of reasonableness, which is beyond the scope of a legal opinion. Nevertheless, customary practice would not permit an opinion giver to rely on a broad statement of this exception for purposes of a provision that is clearly unreasonable, and an opinion giver should expect to address whether a default rate of interest (<i>e.g.</i> , 95% per year), or a provision for the acceleration of future interest without appropriate discount to present value, would be clearly unenforceable, as well as whether any

Survey Provision	Classification
	specific requirements for enforceability other than reasonableness—for example, that the provision be separately initialed, or that it be printed in a specified font size—have been satisfied.)
4. Time-is-of-the-essence clauses.	Generally Enforceable
5. Confession of judgment clauses.	Exception Usually Required (The enforceability of such clauses is affected by applicable statutory provisions that contemplate the existence of a pending action.)
6. Provisions that contain a waiver of broadly or vaguely stated rights.	Exception Usually Required (The enforceability of such provisions is often affected by applicable statutory or constitutional provisions or public policy. A general exception addressing the matters addressed by Survey Provisions nos. 6-9 should be acceptable; an opinion recipient who is concerned about whether a particular provision would be enforceable should request that it be specifically addressed in the opinion.)
7. Provisions that contain a waiver of the benefits of statutory, regulatory, or constitutional rights, unless and to the extent the statute, regulation, or constitution explicitly allows waiver	
8. Provisions that contain a waiver of unknown future defenses.	
9. Provisions that contain a waiver of rights to damages.	
10. Provisions that contain a waiver of obligations of good faith, fair dealing, diligence and commercial reasonableness.	Equitable Principles Limitation
11. Provisions that attempt to change or waive rules of evidence or fix the method or quantum of proof to be applied in litigation or similar proceedings.	Exception Usually Required (The enforceability of such provisions may be limited by public policy.)
12. Provisions for the appointment of a receiver.	Exception Usually Required (The enforceability of such provisions may be affected by applicable statutory provisions.)
13. Forum selection clauses and consent to jurisdiction clauses (as to personal jurisdiction or subject matter jurisdiction).	<ul style="list-style-type: none"> • Outbound (or if the transaction is not subject to Cal. Code Civ. Proc. § 410.40) : Generally Enforceable • Inbound (if the transaction is subject to Cal. Code Civ. Proc. § 410.40): Generally Enforceable • N.B.: Choice of venue clauses (<i>i.e.</i>, clauses that require all actions to be commenced in a particular court in a particular jurisdiction) are generally <i>not</i> enforceable.
14. Provisions appointing one party as an	Generally Enforceable

Survey Provision	Classification
attorney-in-fact for an adverse party.	
15. Waivers of rights to jury trials.	Exception Usually Required (There is currently pending before the California Supreme Court an appeal addressing the enforceability of a provision waiving a party's right to a jury trial.)
16. Provisions that provide that all remedies are cumulative.	Exception Sometimes Required (Such provisions create issues only if the stated remedies are mutually exclusive or legally inconsistent. Perhaps the best example of a transaction in which such issues are presented is a real property secured transaction--outside the scope of this appendix--in which appropriate exceptions should be taken for Cal. Code Civ. Proc. § 726 and other limitations.)
17. Provisions stating that the provisions of a contract are severable.	Generally Enforceable
18. Provisions that purport to waive the defenses available to a guarantor.	Exception Usually Required (Enforceability of such waivers may be limited by applicable statutory provisions. It is not appropriate to request an opinion regarding the sufficiency of the guarantor's waivers.)
19. Provisions that purport to waive a party's right to cure (even where the aggrieved party would not be materially harmed by affording such a right to the breaching party).	Equitable Principles Limitation
20. Provisions requiring arbitration of disputes arising out of the transaction.	Exception Sometimes Required (Arbitration provisions are generally enforceable, but an exception is appropriate with respect to provisions that provide for judicial review of the merits of an arbitration award in violation of applicable statutory provisions or otherwise contain a problematic provision.)
21. Provisions that by their express terms state that fewer than all parties to the contract are entitled to recover attorneys' fees and expenses.	Exception Usually Required (Enforceability of such provisions is affected by Cal. Civ. Code § 1717.)
22. Provisions that prohibit oral modifications.	Generally Enforceable
23. Indemnity of a party for damages arising out of, or that purport to release or exculpate a party from, its own misconduct.	Exception Sometimes Required (Not all indemnities are problematic, but an exception is appropriate if the indemnity in question purports to indemnify a party in a manner that is limited by public policy, such as against its own gross negligence or willful misconduct. In certain cases--for example, with respect to

Survey Provision	Classification
	regulated investment advisers--public policy prohibits indemnification against the indemnified party's own negligence.)
24. Self-help remedy provisions.	Generally Enforceable (Purported authorizations of breaches of the peace are not enforceable, but are covered by the exception discussed at endnote 6.)
25. Indemnification for securities law liabilities.	Exception Usually Required (There are statutory, regulatory, common law and case law limitations on indemnities for securities law liabilities.)
26. Voting agreements.	There appears to be no customary practice with respect to voting agreements. Some opinion givers refuse to opine to the enforceability of voting agreements, which is affected to some extent by applicable statutory provisions that have yet to be interpreted by case law. Some opinion givers do render such opinions, based in part on the fact that there is no case law, after the enactment into law of the applicable statutory provisions, that calls them into question. The Subcommittee takes no position on whether an opinion giver should address the enforceability of a voting agreement.
27. Provisions that grant rights of setoff to participants or to affiliates of parties to the agreement. ¹	Generally Enforceable
28. Provisions that are unconscionable as a matter of law at the time of closing.	Exception Sometimes Required (Refusal to enforce a provision by reason of unconscionability requires both procedural and substantive unconscionability, if the opinion giver also concludes that one of the provisions is substantively unconscionable. Unless the opinion giver is aware of facts that indicate the existence of procedural unconscionability, no exception should be taken.)
29. Provisions that require payments to be made free of any setoff, counterclaim or defense.	Generally Enforceable
30. Provisions that purport to waive any	Exception Sometimes Required (An

¹ This addresses only provisions that grant rights of setoff *to* multiple parties, not provisions that grant rights of setoff *against* multiple parties.

Survey Provision	Classification
applicable statute of limitations.	exception is appropriate if the provision in question is not tailored to take into account applicable statutes.)
31. Provisions that would permit the exercise of remedies without consideration of the materiality of (i) the opinion giver's client's breach, and (ii) the consequences of the breach to the party seeking enforcement.	Equitable Principles Limitation
32. Provisions that would permit the other party to require performance without requiring consideration of the impracticability or impossibility of performance at the time of attempted enforcement due to unforeseen circumstances not within the contemplation of the parties.	Equitable Principles Limitation (An agreement by a party that it will not be excused by certain occurrences, however, is generally enforceable)

SAMPLE LANGUAGE FOR EXCEPTIONS RELATING TO SURVEY PROVISIONS

Survey Provision	Sample language for exception (where appropriate)²
SP No. 2 (Covenants not to compete):	We express no opinion with respect to the effect of California Business and Professions Code § 16600 on the enforceability of [Section ___ of the [Agreement]].
SP No. 5 (Confessions of judgment):	We express no opinion with respect to the enforceability of [Section ___] of [the Agreement].
SP Nos. 6, 7, 8, 9 (Waivers of (i) broadly or vaguely stated rights, (ii) the benefits of statutory, regulatory or constitutional rights, (iii) unknown future defenses, or (iv) rights to damages):	We advise you that waivers of the following may be limited on statutory or public policy grounds: (i) broadly or vaguely stated rights, (ii) the benefits of statutory, regulatory or constitutional rights, (iii) unknown future defenses, or (iv) rights to damages.
SP No. 11 (Attempts to change or waive rules of evidence or fix the method or quantum of proof):	We express no opinion with respect to the enforceability of Section ___ of [the Agreement] [(if necessary for clarity:) as it relates to [rules of evidence] [or] [issues of] [quantum of proof]].
SP No. 12 (Appointment of a receiver):	We express no opinion with respect to the effect of California Code of Civil Procedure § 564 on the enforceability of [Section ___ of the [Agreement]].
SP No. 13 (Forum selection clauses (non-exclusive) and consents to jurisdiction; where there is a choice of venue):	We express no opinion regarding the enforceability of [Section ___] of the [Agreement].
SP No. 15 (Waivers of rights to jury trials):	We express no opinion regarding the enforceability of [Section ___] of the [Agreement].
SP No. 16 (All remedies cumulative):	We express no opinion regarding the enforceability of [Section ___] of the [Agreement].
SP No. 18 (Waiver of a guarantor's defenses):	We advise you of California statutory provisions and case law to the effect that a guarantor may be discharged, in whole or in part, if the beneficiary of the guaranty alters the obligation of the principal, fails to inform the guarantor of material information pertinent to the principal or any collateral, elects remedies that may impair either the subrogation or reimbursement rights of the

² If more than one exception is being taken in an opinion, they may be combined with a single lead-in.

Survey Provision	Sample language for exception (where appropriate) ²
	<p>guarantor against the principal or the value of any collateral, fails to accord the guarantor the protections afforded a debtor under Division 9 of the [California Uniform Commercial Code] or otherwise takes any action that prejudices the guarantor, unless, in any such case, the guarantor has effectively waived such rights or the consequences of such action or has consented to such action. <i>See, e.g.,</i> California Civil Code §§ 2799 through Section 2855; California Uniform Commercial Code § 9-602, <i>Sumitomo Bank of California v. Iwasaki</i>, 70 Cal. 2d 81, 73 Cal. Rptr. 564 (1968); <i>Union Bank v. Gradskey</i>, 265 Cal. App. 2d 40, 71 Cal. Rptr. 64 (1968). While California Civil Code Section 2856, and case law, provide that express waivers of a guarantor's right to be discharged, such as those contained in the [Guaranty], are generally enforceable under California law, we express no opinion with respect to the effectiveness of the waivers in the [Guaranty].</p>
SP No. 20 (Arbitration provisions)	<p>We advise you that a court may refuse to enforce [Section __ of the Agreement], which provides [for judicial review of arbitration awards/other reason]. We express no opinion with respect to the effect of the inclusion of that provision in [the Agreement] upon the enforceability of the parties' agreement to submit disputes to arbitration.</p>
SP No. 23 (Indemnity/Exculpation of a party in respect of its own misconduct)	<p>We advise you that indemnities may be limited on statutory or public policy grounds. [Exculpation covered by the language proposed for SP No. 6, <i>supra</i>.]</p>
SP No. 25 (Indemnification of securities law liabilities)	<p>We express no opinion regarding the enforceability of [Section __] of the [Agreement] [to the extent that it would require [the opinion giver's client] to indemnify [the opinion recipient] in respect of [the opinion recipient's] violations of securities laws].</p>
SP No. 28 (Unconscionability at time of closing):	<p>If the opinion giver believes that procedural unconscionability exists with respect to one or more provisions of the contract, the opinion giver should decline to deliver an opinion with</p>

Survey Provision	Sample language for exception (where appropriate) ²
	respect to those provisions, or, if the opinion giver's client consents, should disclose his/her concerns.
SP No. 30 (Waivers of statute of limitations):	We advise you that the waiver of the applicable statute of limitations set forth in Section ____ of [the Agreement] will be subject to the limitations of [the relevant statutory limitation].

ANNEX B

DISCUSSION

1. CHOICE OF LAW. This was identified in 1992 as a California Qualification. Subsequently, in *Nedlloyd Lines B.V. v. Superior Court*, 3 Cal. 4th 459, 462 (1992) (involving an “outbound” choice of law), the California Supreme Court recognized the existence of “strong policy considerations favoring the enforcement of freely negotiated choice-of-law clauses,” and adopted the approach of Restatement (Second) Conflict of Laws § 187 (“Restatement of Conflicts”): if the chosen state has a reasonable relationship to the parties or to their transaction, or there is some other reasonable basis for the parties’ choice of law, the choice of law will be given effect unless (1) the law of the chosen state is contrary to a fundamental policy of the state (whether California or some other state) whose law would apply in the absence of a choice-of-law clause, and (2) that state is determined to have a “materially greater interest than the chosen state in the determination of the particular issue¹.” Since *Nedlloyd*, it has been held that “the mere fact that one of the parties to the contract is incorporated in the chosen state is sufficient to support a finding of a ‘substantial relationship.’” *Application Group, Inc., v. Hunter Group, Inc.*, 61 Cal. App. 4th 881, 899 (1998); see also *Hambrecht & Quist Venture Partners v. American Medical International, Inc.*, 38 Cal. App. 4th 1532, 1546 (1995).

Given this standard, the Subcommittee concluded that, where the chosen law is the law of the State of California and there is some articulable basis for choosing California law (*e.g.*, domicile/place of incorporation of a party), there should be no need either (1) to disclaim any opinion regarding the enforceability of the choice of law provision, or (2) to address separately the choice of law in the exceptions to the opinion.

In addition, Cal. Civ. Code § 1646.5, which authorizes the parties to a transaction involving at least \$250,000 to select California law as their governing law, provides an independent basis to provide an opinion that a court will enforce a provision choosing California law. There are no published cases addressing Section 1646.5, but *Hilton Inns, Inc. v. Gulf Beach Hotel, Inc.* (9th Cir. 1996), available at 1996 WL 468637, and *Unit Process Co. v. Raychem Corp.*, a California Court of Appeal case that was not officially published (available at 2002-1 Trade Cases P 73,592, and 2002 Westlaw 173286), both support the enforceability of choice of law provisions under Section 1646.5. Case law considering New York General Obligation Law § 5-1401, upon which Section 1646.5 is modeled, and addressing its relationship to the Restatement has held that Section 5-1401, as a statutory provision directly addressing choice of law and incorporating its own set of exceptions, takes precedence over the common law principles in the Restatement that would require, absent some relation to the chosen state, that in some instances consideration be given to conflict with a fundamental policy of another jurisdiction. See, *e.g.*, *Lehman Brothers Commercial Corporation v. Minmetals International Non-Ferrous Metals Trading Co.*, 179 F. Supp.2d 118, 138 (S.D.N.Y. 2000).

Where the law chosen to govern an agreement being opined upon is the law of another state, the opinion giver could also, based on the *Nedlloyd* discussion above, give an opinion that a California court would enforce the choice of law clause. This opinion would be based on the same considerations as when an opinion is given on a choice of law clause choosing California

¹ *Id.* at 466.

law and Cal. Civ. Code § 1646.5 does not apply for some reason. (Note that Cal. Civ. Code § 1646.5 never applies when the choice of law clause chooses the law of a jurisdiction other than California.)

Where the law chosen to govern an agreement being opined upon is the law of another state, customary practice (which, formerly, often involved engaging separate counsel qualified in the jurisdiction whose law was chosen to give the remedies opinion) now greatly favors permitting the primary opinion giver to render an opinion to the effect that, if the law of the State of California were held to apply to the agreement, notwithstanding the choice of law of another jurisdiction, the agreement would be enforceable. (It is the Subcommittee's view that a remedies opinion given under California law with respect to such an agreement, without more, should be understood to address only the enforceability, under California law, of the provisions of the agreement setting forth that choice of law. As the 1998 TriBar Report notes, however (at § 4.6), this approach "lacks general acceptance," and the Subcommittee recommends that it be avoided, absent the inclusion of language, agreed upon with counsel for the opinion recipient, clarifying that the remedies opinion is so limited.)

It is not uncommon for an opinion recipient who has agreed to accept a remedies opinion rendered under California law with respect to an agreement governed by other law to request in addition a separately stated opinion to the effect that the choice of law set forth in the agreement will be respected by the courts of the State of California. California lawyers have historically declined to give that opinion. In light of the considerable development in the case law over the last decade and a half, however, the Subcommittee believes it appropriate for this practice to change. If the chosen law is the law of another state, and there is either a reasonable relationship to that other state or another reasonable basis for choosing the law of that state, a California court should give effect to that choice of law, unless it determines both that (i) the application of the chosen law would be contrary to a fundamental policy of the jurisdiction whose law would apply in the absence of a choice-of-law clause and (ii) the other jurisdiction has a materially greater interest in the application of its law than does the chosen-law state. The Subcommittee believes that an opinion in the following form would be appropriate:

Based on [describe contact or basis for choosing law of chosen state], the court should give effect to [§ xx – the choice-of-law clause] of the Agreement.

If the opinion giver is not asked to render an opinion with respect to the enforceability of an agreement under California law (in which case, general issues of enforceability would be addressed in rendering the remedies opinion), but is asked only to render an opinion regarding the enforceability of the parties' choice of law, an opinion giver may, if it desires, add the following qualifying clauses:

, except to the extent that any provision of [the Agreement] (i) is determined by the court to be contrary to a fundamental policy of the state whose law would apply in the absence of a choice-of-law clause, and (ii) that state has a materially greater interest in the determination of the particular issue than does the state whose law is chosen.

The reference to the public policy of a state or country that has a materially greater interest than the chosen state in the determination of a particular dispute is based on Restatement of Conflicts § 187(2)(b); the other state or country would be the jurisdiction that, under § 188, “would be the state of the applicable law in the absence of an effective choice of law by the parties.” The reference to the law of the chosen-law state recognizes that the opinion refers only to the application of the substantive law of the chosen state. The Subcommittee does not believe the inclusion of this exception to be necessary, however: the opinion addresses only California law, and not the possible existence of another jurisdiction with a fundamental policy that might be violated by the application of the chosen law to that issue; nor does the opinion address whether California, or any other jurisdiction, would have a materially greater interest in the determination of the issue in question. This is consistent with customary opinion practice to the effect that lawyers giving an opinion are not expected to review the law of a state the law of which is not covered by the opinion or to determine the strength of a jurisdiction’s interest in the determination of an issue. Nor could a party to an agreement reasonably expect a California court to apply another jurisdiction’s rules of civil procedure. The exceptions should, as a matter of customary usage, be understood to apply to any opinion regarding a choice of law clause, whether or not they are stated.

While it is almost inconceivable that a party would insist on a legal opinion in a transaction involving less than \$250,000—the threshold amount for application of Section 1646.5—and the Subcommittee believes that, absent extraordinary circumstances, it would be manifestly unreasonable for a party to such a contract to refuse to close without such an opinion, counsel finding itself having to render an opinion in such a transaction would apply the same analysis just stated with respect to the choice of the law of a jurisdiction other than California.

The following examples of policies that have been found by California to be either fundamental or not are included for purposes of illustration only, to provide background for the preceding discussion. California opinion givers do not customarily opine as to what constitutes a fundamental policy of the State of California.²

Examples of Fundamental Policies of California

California Business and Professions Code (“B&P Code”) § 16600 states: “[e]xcept as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void.” B&P Code § 16600. In *Application Group, Inc. v. Hunter Group, Inc.*, 61 Cal. App. 4th 881 (1998), the court applied California law to a dispute over a non-compete clause in an employment contract despite the contract’s Maryland choice-of-law provision. The dispute directly implicated B&P Code § 16600, which the court stated “reflects a ‘strong public policy’ of the State” to allow persons employment mobility. 61 Cal. App. 4th at 900. *See also Scott v. Snelling & Snelling, Inc.*, 732 F. Supp. 1034, 1041 (N.D. Cal. 1990) (holding that California law applied “to the question of . . . enforceability of . . . covenants restricting competition in . . . franchise agreements . . . despite the choice of law provision nominating Pennsylvania law . . . because of the strong public

² But see the “Final Admonition,” *supra*, regarding the delivery of misleading opinions.

policy of California embodied in section 16600, the lack of an applicable statutory exception to section 16600, and the broadly inclusive language of the statute.”).

California Labor Code § 221 “makes it unlawful ‘for any employer to collect or receive from an employee any part of wages theretofore paid by said employer to said employee.’” *International Business Machines v. Bajorek*, 191 F.3d 1033, 1038 (9th Cir. 1999) (quoting Cal. Lab Code § 221). It is possible that enforcement of a choice-of-law provision contrary to this section would violate a fundamental policy of California. The court in *IBM* did not reach this question because it held “wages” were not in dispute. *Id.* at 1039-40.

Cal. Civ. Code § 1717 provides that an attorney’s fee clause in a contract shall be construed to award the prevailing party attorney’s fees regardless of whether the prevailing party was named in the clause. *See* Cal. Civ. Code § 1717(a). In addition, the “section shall not be subject to waiver by the parties to any contract which is entered into after the effective date of this section. Any provision in any such contract which provides for a waiver of attorney’s fees is void.” *Id.* In *Ribbens Int’l, S.A. de C.V. v. Transport Int’l Pool, Inc.*, 47 F. Supp. 2d 1117, 1119-22, 1126 (C.D. Cal. 1999), the court applied California law to an attorney’s fee provision in a contract despite the contract’s Pennsylvania choice-of-law provision and the court’s application of Pennsylvania law to issues of liability and damages. Application of Pennsylvania law on this point would have been contrary to section 1717, which the court held was a fundamental policy of California. .

California Code of Civil Procedure § 580b bars deficiency judgments in connection with certain transactions secured by real property. *See* Cal. Code Civ. Proc. § 580b. In *Guardian Savings & Loan Ass’n v. MD Associates*, 64 Cal. App. 4th 309, 320 (1998), the court held that “the statute reflects a ‘fundamental policy’ of the state within the meaning of section 187 of the Restatement.” But the court enforced a Texas choice-of-law provision despite the fact that it was contrary to a fundamental policy of California because California did not have a materially greater interest in enforcing its law than did Texas, based on the facts of that case. *Id.* at 323. Based upon the reasoning of this opinion, it is likely that the other three statutory components of California’s “one action” and “anti-deficiency” rules applicable to debts secured by real property, *i.e.*, Code of Civil Procedure Sections 580a, 580d and 726, would also be held to constitute fundamental principles of California law.

Under California Labor Code § 3852, third party “tortfeasors [are required] to reimburse employers for workers’ compensation benefits paid as a result of their negligence.” *Dailey v. Dallas Carriers Corp.*, 43 Cal. App. 4th 720, 725 (1996). This section embodies a “fundamental policy of this state.” *Id.* In *Dailey*, the court refused to enforce an Ohio choice-of-law provision because its application was contrary to section 3852. *Id.* at 722-23, 726.

California Insurance Code § 11580(b)(1) requires that certain insurance policies issued or delivered to persons in California must contain a “provision that the insolvency or bankruptcy of the insured will not release the insurer from the payment of damages for injury sustained or loss occasioned during the life of such policy.” *Haisten v. Grass Valley Medical Reimbursement Fund, Ltd.*, 784 F. 2d 1392, 1402 (9th Cir. 1986) (quoting Cal. Ins. Code § 11580(b)(1)). California Insurance Code § 1619 “provides that attorney’s fees may be awarded if an insurer has ‘failed for thirty days after demand prior to the commencement of the action to make

payment in accordance with the terms of the contract, and it appears to the court that such refusal was vexatious and without reasonable cause.” *Id.* at 1406. In *Haisten*, the Ninth Circuit did not enforce a Cayman Islands choice-of-law clause and applied the California Insurance Code because “a court is not bound by a contract’s choice of law provision if strong public policy requires the application of California law.” *Id.* at 1402-03. A strong public policy was involved because “[p]rotection of California residents from the potential risk of injury thought to be created by insurance and from the unscrupulous practices of insurance companies which profit from premiums from California constitute sufficient interest to apply California law.” *Id.* at 1403.

“California [has a] policy . . . to protect the public from fraud and deception in securities transactions. The Corporate Securities Law of 1968 was enacted to effectuate this policy by regulating securities transactions in California and providing statutory remedies for violations of the Corporations Code, in addition to those available under common law. The cornerstone of the law is section 25701, which provides, ‘Any condition, stipulation or provision purporting to bind any person acquiring any security to waive compliance with any provision of this law . . . is void.’” *Hall v. Superior Court*, 150 Cal. App. 3d 411, 417 (1983). In *Hall*, the court declined to enforce a Nevada choice-of-forum provision because its enforcement would lead to the enforcement of a choice-of-law provision that would likely be contrary to the fundamental policy of California embodied in the Corporate Securities Law of 1968. *See id.* at 418-19.

Examples of What Do Not Constitute Fundamental Policies of California

Application of foreign law that changes the statute of limitations is likely not contrary to a fundamental policy of California if the change is reasonable. *See Hambrecht*, 38 Cal. App. 4th at 1548-49. “[E]xcept as restricted by statute, California courts accord contracting parties substantial freedom to modify the length of the statute of limitations.” *Id.* at 1548. “As the Supreme Court has stated in permitting parties to shorten the limitations period: ‘[S]uch statutes [of limitations] are regarded as statutes of repose, carrying with them, not a right protected under the rule of public policy, but a mere personal right for the benefit of the individual, which may be waived.’” *Id.* (quoting *Tebbetts v. Fidelity and Cas. Co. of New York*, 155 Cal. 137, 139 (1909)). *See also Hughes Electronics Corporation v. Citibank Delaware* 120 Cal. App. 4th 251 (2004) (citing *Hambrecht* with approval).

A “potential difference in the law of . . . two competing forums pertaining to forfeitures in license agreements does not amount to a conflict involving fundamental policy in California.” *CQL Original Products, Inc. v. National Hockey League Players’ Ass’n*, 39 Cal. App. 4th 1347, 1357 (1995). In *CQL*, the court determined the enforceability of a choice-of-forum clause that contained a choice-of-law clause. *Id.* at 1351. Under the choice-of-forum analysis, a clause is not enforceable if it is unreasonable. *Id.* at 1353. One basis for unreasonableness is a resulting application of foreign law that is contrary to a fundamental policy of California. *Id.* at 1357. The court enforced the choice-of-forum clause leading to enforcement of the choice-of-law clause because the application of the foreign law was not contrary to a fundamental policy of California. *Id.* at 1357-58.

Application of foreign law that permits an interest rate that would be usurious under California law is not contrary to a fundamental public policy of California under California’s

usury laws. See *Ury v. Jewelers Acceptance Corp.*, 227 Cal. App. 2d 11, 20-21 (1964) (enforcing a contract under New York law despite the resulting application of interest rates usurious under California law); *Gamer v. duPont Glove Forgan, Inc.*, 65 Cal. App. 3d 280, 290 (1976) (holding “that the particular contract in question, which by its choice of law provision permitted a charge of interest legal in New York though in excess of the legal rate then permitted in California, did not offend against a policy of California law”); *Mencor Enterprises, Inc. v. Hets Equities Corp.*, 190 Cal. App. 3d 432, 440-41 (1987) (holding that whether enforcement of a foreign choice-of-law provision resulting in application of interest rates usurious under California law is contrary to a fundamental policy of California is a question of fact that needs to be determined through evidentiary hearings).

2. COVENANTS NOT TO COMPETE. This was identified in 1992 as a California Qualification. As noted above with respect to choice-of-law provisions, California Business and Professions Code (“B&P Code”) §§ 16600 et seq. place severe restrictions upon the enforcement of a covenant not to compete. Covenants not to engage in business or to compete with another party are considered contracts in restraint of trade and are not enforceable except in connection with certain sales of businesses, and are subject to B&P Code §§ 16600-16602.5. These sections are not understood to codify equitable principles.

Judicial interpretations of these code sections are numerous but provide no bright line test, often depending on the precise factual situation at the time such enforcement is sought. As one court explained, “the California statute does not except ‘reasonable’ restraints of trade, it ‘only makes illegal those restraints which preclude one from engaging in a lawful profession, trade, or business.’” *International Business Machines v. Bajorek*, 191 F.3d 1033, 1040 (9th Cir. 1999) (quoting B&P Code § 16600). Certain provisions not constituting a prohibition on employment by a competitor, but which limit one’s ability to compete can and have been enforced. For example, provisions in employment contracts prohibiting an employee from using confidential information taken from the former employer have been held to be lawful. See *Gordon v. Landau*, 49 Cal. 2d 690, 694 (1958). In addition, a contract provision restraining an employee from “disrupting, damaging, impairing or interfering” with his former employer by raiding its employees was held valid. *Loral Corp. v. Moyes*, 174 Cal. App. 3d 268 (1985).

Further, B&P Code § 16601 allows for covenants not to compete for anyone who sells the goodwill of a business or all of the ownership interest in a business entity and for any owner of a business which sells all or substantially all of its operating assets together with its goodwill or the operating assets of a subsidiary or a division along with its goodwill. There must be, however, “clear indication that . . . the parties valued or considered goodwill as a component of the sales price.” *Hill Medical Corp. v. Wycoff*, 86 Cal. App. 4th 895, 903 (2001).

Exceptions to the general prohibition also apply under B&P Code §16602 in connection with the dissolution of a partnership or a disassociation of a partner from a partnership if the business of the partnership is carried on, and under §16602.5 in connection with the dissolution of a limited liability company if the business of the limited liability company is carried on.

B&P Code §§ 16601, 16602 and 16602.5 all restrict the geographic scope of the noncompetition covenants. Effective January 1, 2003 (see AB 601, enacted in 2002), the scope became limited to “a specified geographic area” where the relevant business entity “business has

been transacted” or “been carried on.” Previously the statutes had referred to “specified county or counties, city or cities or a part thereof,” and case law had held that this language did not limit the scope to the boundaries of California. *Monogram Indus., Inc. v. Sar Indus., Inc.*, 64 Cal. App. 3d 692 (1976), Cal. Bus. Prof. Code § 16601 - the scope may extend nationwide and beyond; and *Fleming v. Ray-Suzuki, Inc.*, 225 Cal. App. 3d 574 (1990), which followed *Monogram* in holding that the scope of a covenant not to compete may be nationwide, which encompasses an accumulation of counties and cities to be impacted.

The Subcommittee believes that it is customary for California opinion givers to disclaim any opinion regarding the enforceability of such covenants. The Subcommittee recommends that, unless the covenant is clearly unenforceable (as would be a covenant not to compete based solely on a contract of employment), the exception be worded in a way that refers the opinion recipient to the relevant limiting statute:

We express no opinion with respect to the effect of California Business and Professions Code §§ 16600 *et seq.* on the enforceability of [Section __ of the [Agreement]].

3. PROVISIONS FOR PENALTIES. This was identified in 1992 as a California Qualification.

Generally, economic remedy provisions are carefully reviewed under California law. *See, e.g.*, Cal. Civ. Code §§ 3275, 3358, 3359, 3369, 1671 (relating to liquidated damages),³ and Cal. Civ. Code § 2954.5 (restricting late payment charges on certain residential real estate loans). Certain of these statutes codify equitable principles. For example, courts repeatedly refer to the granting of “equitable relief” under Section 3275. *Lauderdale Associates v. Department of Health Services*, 67 Cal. App. 4th 117 (1998); *Moeller v. Lien*, 25 Cal. App. 4th 822 (1994); *Simons v. Young*, 93 Cal. App. 3d 170 (1979). *See also Christin v. Story*, 119 Cal. App. 326, 334 (1931) (“The provisions of [Section 3275] are equitable in their nature and he who seeks their benefits must at least show that he is ready, willing and able to do all that should reasonably be required of him under the circumstances.”); and *Freedman v. The Rector* 37 Cal. 2d 16, 19-22 (1951) (“The breaching party may raise section 3275 as an equitable defense to enforcement of the contractual provision or as grounds for relief in an action for restitution of the property forfeited.”). According to Witkin, Cal. Civ. Code § 3369 is a codification of an equitable doctrine at 11 Witkin, *Summary of Cal. Law* (9th Ed.) Equity, § 18).

Courts, in any event, have not hesitated to invalidate charges on the grounds that they were penalties. *See Ridgley v. Topa Thrift & Loan Ass’n*, 17 Cal. 4th 970, 977 (1998) (“[t]he amount set as liquidated damages [as late charges] ‘must represent the result of a reasonable endeavor by the parties to estimate a fair average compensation for any loss that may be sustained.’” (quoting *Garrett v. Coast & S. Fed. Sav. & Loan Ass’n*, 9 Cal. 3d 731, 739 (1973))). Other similar charges must also withstand scrutiny as liquidated damages. *See Hitz v. First Interstate Bank*, 38 Cal. App. 4th 274 (1995), and *Beasley v. Wells Fargo Bank*, 235 Cal. App.

³ Under Cal. Civ. Code § 1671(b), however, absent another statute expressly applicable to the issue, a liquidated damages provision in a commercial contract is valid unless the party seeking to invalidate the provision establishes that it was unreasonable under the circumstances existing at the time the contract was made.

3d 1383 (1991) (absent a bank's reasonable endeavor to estimate fair average compensation for loss from late payment and overlimit activity, fees for such payment or activity were not valid as liquidated damages); *Sybron Corp. v. Clark Hosp. Supply Corp.*, 76 Cal. App. 3d 896 (1978) (provision increasing amount owed if obligation not paid by a specific date invalidated because increase did not bear reasonable relationship to damages caused by late payments); *Puritan Leasing Co. v. August*, 16 Cal. 3d 451, 456 (1976) (the court, citing numerous intermediate appellate court decisions, noted that "simple" acceleration clauses in leases, which permit the lessor to hold the lessee immediately liable for all rent reserved upon default in payment of one installment, are invalid under the liquidated damages statute; provisions for the acceleration of future amounts due (other than principal) without appropriate discount to present value have often been declared unenforceable on various theories as penalties, forfeitures or unreasonable attempts to liquidate damages).

Although prepayment charges (sometimes viewed as optional prepayment penalties that provide the borrower an alternative method of performance) are generally enforceable, several limiting principles exist: exorbitant prepayment penalties will not be enforced (*Williams v. Fassler*, 110 Cal. App. 3d 7 (1980); *Lazzareschi Inv. Co. v. San Francisco Fed. Sav. & Loan Ass'n*, 22 Cal. App. 3d 303 (1971)); Cal. Civ. Code § 2985.6; a lender may not collect unearned interest (*Furesz v. Garcia*, 120 Cal. App. 3d 793 (1981)); and a lender may not be permitted to accelerate a debt upon default and then enforce a prepayment penalty (Cal. Civ. Code § 2954.10 (debt secured by residential property containing four units or less), § 2954.9(b) (limits prepayment charges on loans secured by "owner occupied" residential property)). Some question has been raised about the enforceability of an increase in interest rates following a default. See *Arnett v. Union Bank*, 151 Cal. Rptr. 163 (1978) (increase in interest rates on defaulted amounts upheld) (opinion ordered not published by the California Supreme Court).⁴

In general, courts evaluate such provisions according to a reasonableness standard that contemplates the parties' circumstances at the time of contract formation, and the exact standard that will be applied is difficult, if not impossible, to predict. The Subcommittee believes that opinion givers should not be expected to determine whether a given economic remedy is reasonable, and that, as a matter of customary practice, a remedies opinion should be understood as not extending to the reasonableness of such remedies.⁵ (Of course, an opinion giver should take an express exception for an economic remedy that (i) is plainly unreasonable on its face, or (ii) exceeds an applicable statutory or constitutional limit (*i.e.*, one that is not merely subject to a reasonableness standard), and should point out any requirement that such a provision be capitalized, separately initialed, or the like.) (See, *e.g.*, Cal. Civ. Code § 2954.10).)

4. TIME OF ESSENCE. This was identified in 1992 as a California Qualification. Under California law, time is of the essence clauses may be unenforceable where enforcement would work as an unfair penalty or forfeiture. See Cal. Civ. Code § 3275; *Valley View Home of*

⁴ Under California Rule of Court No. 977, an unpublished case may not be cited or relied upon by a court or a party in any other action or proceeding except when it is relevant under the doctrines of law of the case, *res judicata*, or collateral estoppel, or when it is relevant to a criminal or disciplinary action or proceeding because it states reasons for a decision affecting the same defendant or respondent in another such action or proceeding. *Arnett* is nevertheless cited here because of the paucity of recent authority.

⁵ *Accord*, TriBar Remedies Opinion Report, Paragraph III.B.

Beaumont, Inc. v. Department of Health Services, 146 Cal. App. 3d 161, 168 (1983) (“Relief from forfeiture when the facts and equities militate in favor thereof may be granted even when the party seeking it has violated an express condition precedent, such as where time is made of the essence.”). Section 3275 (disfavoring forfeitures), as noted *supra*, endnote 3, is acknowledged to codify equitable principles. The Subcommittee believes it unnecessary to state a separate exception with respect to such time is of the essence clauses.

5. CONFESSIO OF JUDGMENT. This was identified in 1992 as a California Qualification. Confessions of judgment are subject to Cal. Code Civ. Proc. §§ 1132-34. Those sections permit a judgment by confession to be entered only if “an attorney independently representing the defendant signs a certificate that the attorney has examined the proposed judgment and has advised the defendant with respect to the waiver of rights and defenses under the confession of judgment procedure and has advised the defendant to utilize the confession of judgment procedure.” The attorney’s certificate must be filed with a statement, signed by the defendant under oath, that, among other things, authorizes the entry of judgment for a specified sum—something that in a standard commercial transaction could only rarely, if ever, be prepared before the commencement of an action. The requirements are “exclusive and must be strictly construed.” 6 Witkin, California Procedure, “Proceeding Without Trial”, §§ 255 et. seq.; they do not codify equitable principles. Thus, if an agreement being opined upon contains a confession of judgment, it would be appropriate for an opinion giver to expressly exclude any opinion regarding the enforceability of the relevant provision, which could be worded as follows:

We express no opinion with respect to the enforceability of [Section ____] of [the Agreement].

6. WAIVERS OF (i) BROADLY OR VAGUELY STATED RIGHTS, (ii) STATUTORY OR CONSTITUTIONAL RIGHTS, (iii) UNKNOWN FUTURE DEFENSES, OR (iv) RIGHTS TO DAMAGES. These Survey Provisions were collectively identified in 1992 as a California Qualification, and, as did the drafters of that report, the Subcommittee believes it appropriate to treat them together.

(i) (Broadly or vaguely stated rights.) Waivers of broadly or vaguely stated rights risk running afoul of (i) statutory prohibitions based on public policy concerns that would invalidate even clearly defined, express waivers, (ii) judicially-imposed knowledge and intent requirements or (iii) express non-waiver provisions. Moreover, California has codified a general prohibition against waivers of any rights in violation of public policy. Cal. Civ. Code § 3513: “Anyone may waive the advantage of a law intended solely for his benefit. But a law established for a public reason cannot be contravened by a private agreement.” Thus, courts might be expected to invalidate overly broad or vague waivers on the basis of their perceived interference with rights rooted in the public interest. *See, e.g., Winklemen v. Sides*, 31 Cal. App. 2d 387, 405 (1939) (discussing statutes applying to creditors, noting, “As those statutes were passed to promote the public welfare by protection of the debtor class from oppression, they must be construed as declaring a public policy of the state and they cannot be waived by contract.”). Waivers of power-of-sale foreclosure procedures and certain one-action rule and anti-deficiency protections are particularly vulnerable. *See* Cal. Civ. Code § 2953; Cal. Code Civ. Proc. §§ 580b, 580d; *Palm v. Schilling*, 199 Cal. App. 3d 63 (1988); *DeBerard Props., Ltd. v. Lim*, 20

Cal. 4th 659 (1999); *Freedland v. Greco*, 45 Cal. 2d 462 (1955) (dictum); *Union Bank v. Brummell*, 269 Cal. App. 2d 836 (1969) (dictum).

(ii) (Statutory or constitutional rights.) Some statutes expressly prohibit waivers of the rights they afford. For example, at the federal level, the Securities Exchange Act of 1934, as amended, § 29, states that “any . . . stipulation or provision binding any person to waive compliance with any provision of this title or of any rule or regulation . . . shall be void.” *See also, e.g.*, B&P Code § 6412.5 (“Any waiver of the provisions of this chapter is contrary to public policy, and is void and unenforceable.”); B&P Code § 10248.2 (“A borrower may not waive any right or remedy under this article.”); Cal. Civ. Code § 800.24 (“Any waiver of these rights shall be deemed contrary to public policy and void.”); Cal. Corp. Code § 25701 (“Any condition, stipulation or provision purporting to bind any person acquiring any security to waive compliance with any provision of this law or any rule or order hereunder is void.”); and Cal. UCC § 9602 (“Except as otherwise provided in Section 9624, to the extent that they give rights to a debtor or obligor and impose duties on a secured party, the debtor or obligor may not waive or vary the rules stated in the following listed sections . . .”). (*See also* paragraph (iv) of this endnote, *infra*.)

Even where waivers are permitted, courts have created a judicial “test” of enforceability. In *Outboard Marine Corp. v. Superior Court*, the court stated:

To constitute a waiver, it is essential that there be an existing right, benefit, or advantage, a knowledge, actual or constructive, of its existence, and an actual intention to relinquish it or conduct so inconsistent with the intent to enforce the right in question as to induce a reasonable belief that it has been relinquished. The doctrine of waiver is generally applicable to all the rights and privileges to which a person is legally entitled, including those conferred by statute unless otherwise prohibited by specific statutory provisions.

52 Cal. App. 3d 30, 41 (1975). *See also Record v. Indemnity Ins. Co. of N. Am.*, 103 Cal. App. 2d 434, 445 (1951) (“[P]rimary essentials of a waiver are knowledge and intent.”). Furthermore, the “question of waiver is a question of fact . . .” *Trujillo v. City of Los Angeles*, 276 Cal. App. 2d 333, 343 (1969). Thus, a waiver of these rights that was not clearly expressed would seem unlikely to survive judicial scrutiny. Knowledge and intent becomes more difficult to infer as the description of rights purported to be waived becomes increasingly broad or vague.

(iii) (Unknown future defenses.) Cal. Civ. Code § 1542 provides that “A general release does not extend to claims which the creditor does not know or suspect to exist in his favor at the time of executing the release, which if known by him must have materially affected his settlement with the debtor.” Generally speaking, courts will enforce waivers of the protections provided by Section 1542. *See, e.g., Pacific Greyhound Lines v. Zane*, 160 F. 2d 731, 736 (9th Cir. 1947) (“In the absence of actual fraud, the express waiver of all rights under this section (1542) was valid.”); *Winet v. Price*, 4 Cal. App. 4th 1159 (1992) (holding that general releases can be completely enforceable); *Grace v. eBay Inc.*, 120 Cal. App. 4th 984, 998 (2004) (holding that a court construes a release “under the same rules of construction applicable to other contracts,” and that, “[a]bsent extrinsic evidence to the contrary, a broadly worded release, such as a release of ‘all claims,’ covers all claims within the broad scope of the language

even if particular claims are not expressly enumerated or described more particularly in the release”). As with Cal. Civ. Code § 3513, however, courts require that the party waiving section 1542 protections have both a knowledge of his rights afforded thereunder and an intent to execute such a waiver. *See San Diego Hospice v. County of San Diego*, 31 Cal. App. 4th 1048 (1995) (discussing knowledge and intent); *Leaf v. City of San Mateo*, 104 Cal. App. 3d 398, 411 (1980) (stating that “[w]hether the releaser intended to discharge such claims or parties is ultimately a question of fact.”); *Casey v. Proctor*, 59 Cal. 2d 97, 110 (1963) (“The question remains as one of fact whether the releaser actually intended to discharge such claims.”).

(iv) (Rights to damages.) A secured party’s liability for damages resulting from its failure to comply with Division 9 of the California Uniform Commercial Code, under Section 9625 or 9626 (such as a claim for the recovery of damages for the loss of a surplus caused by a secured party’s failure to conduct a commercially reasonable sale of collateral, for example), may not be waived. Waivers of punitive damages are unlikely to be enforceable. Punitive damages are generally not available in contract actions per se (Cal. Civ. Code § 3294); they may, however, be recovered in respect of a claim that arises in or as part of the contractual relationship, but that involves the commission of a tort. *See, e.g., Haigler v. Donnelly*, 18 Cal. 2d 674, 680 (1941) (“ . . . if the action is in tort such damages may be recovered upon a proper showing of malice, fraud or oppression, even though the tort incidentally involves a breach of contract”). At least one court has intimated that Cal. Civ. Code § 1668, which provides that contracts that purport to exempt someone “from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law,” may render a waiver of punitive damages ineffectual. *Pardee Construction Co. v. Superior Court*, 100 Cal. App. 4th 1081, 1091 (2002); *but see J. Alexander Securities, Inc. v. Mendez*, 17 Cal. App. 4th 1083, 1093 (1993), indicating that, under appropriate circumstances, such a waiver might be enforced: “The cash account agreement does not explicitly address the issue of punitives, nor should respondent, a consumer residing in Los Angeles, have been expected to know the applicable provisions of New York law or the NASD rules concerning punitive damages. Without a voluntary and intentional relinquishment of a known right, respondent cannot be deemed to have waived her right to punitive damages.” [Citations omitted.] *See also* endnote 23, *infra*.

Language such as the following is commonly used by California opinion givers to address the issues of enforceability discussed in this endnote 6:

We advise you that waivers of the following may be limited on statutory or public policy grounds: (i) broadly or vaguely stated rights, (ii) the benefits of statutory, regulatory or constitutional rights, (iii) unknown future defenses, or (iv) rights to damages.

7. [Waivers of statutory or constitutional rights] See endnote 6.
8. [Waivers of unknown future defenses] See endnote 6.
9. [Waivers of rights to damages] See endnote 6.

10. PROVISIONS THAT CONTAIN A WAIVER OF OBLIGATIONS OF GOOD FAITH, FAIR DEALING, DILIGENCE AND COMMERCIAL REASONABLENESS. “Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.” *Carma Developers (Cal.), Inc. v. Marathon Development California, Inc.*, 2 Cal. 4th 342, 371 (1992) (citations omitted). “The covenant of good faith finds particular application in situations where one party is invested with a discretionary power affecting the rights of another. Such power must be exercised in good faith.” *Id.* at 372. The duty does not appear to be subject to waiver (see, e.g., *Beck v. Farmers Insurance Exchange*, 701 P.2d 795, 800 n. 4 (Utah 1985): “The duty to perform the contract in good faith cannot, by definition, be waived by either party to the agreement.”). Nevertheless, “the parties may, by express provisions of the contract, grant the right to engage in the very acts and conduct which would otherwise have been forbidden by an implied covenant of good faith and fair dealing.” *Id.* at 374, citing *VTR, Incorporated v. Goodyear Tire & Rubber Company*, 303 F. Supp. 773, 777-778 (S.D.N.Y. 1969) (i.e., a contract may not waive generally the obligation to act in good faith, but it may expressly provide that a party is entitled to “do X”, where “doing X”, in the absence of an express provision to that effect, would violate the duty of good faith). It may not be read to prohibit a party from doing that which is expressly permitted by an agreement, but it may prohibit conduct that is not prohibited but is nevertheless “contrary to the contract’s purposes and the parties’ legitimate expectation.” *Id.* at 373. In transactions subject to the California Uniform Commercial Code, “the obligations of good faith, diligence, reasonableness and care prescribed by [the California Uniform Commercial Code] may not be disclaimed by agreement, but the parties may by agreement determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable.” Cal. UCC § 1102(3). “Diligence” is also an element of avoiding application of the equitable defense of laches.

As discussed above, in Part I.B. of this appendix, the 1989 Report (by means of its recommended wording of the equitable principles limitation), the Accord (by express inclusion of such principles in Section 13), and the 1998 TriBar Report (in its discussion of the equitable principles limitation), concur that the principles addressed in this endnote are, conceptually, equitable principles that fall within the scope of the equitable principles limitation.

11. PROVISIONS THAT ATTEMPT TO CHANGE OR WAIVE RULES OF EVIDENCE OR FIX THE METHOD OR QUANTUM OF PROOF TO BE APPLIED IN LITIGATION OR SIMILAR PROCEEDINGS. This was identified in 1992 as a California Qualification. Under California law, contractual provisions that attempt to change or waive rules of evidence or fix the method or quantum of proof to be applied in litigation or similar proceedings may not be enforceable, due to public policy limitations. See, e.g., *Conwell v. Varian*, 20 Cal. App. 521 (1912); *Berry v. Chaplin*, 74 Cal. App. 2d 652 (1946); *Robinson v. Wilson*, 44 Cal. App. 3d 92 569 (1974) (stipulation between the parties to limit evidence the court could consider in ruling on the merits held invalid); *Aydin Corporation v. First State Insurance Co.*, 18 Cal. 4th 1183 (1998) (no compelling reason to alter the burden of proof with respect to insurance coverage for pollution discharge, due to the State’s strong public policy to prevent, eliminate and reduce pollution); *McCormick v. Woodmen of the World*, 57 Cal. App. 568 (1922) (clause in insurance contract attempting to alter a statutory rule of evidence held void).

The Subcommittee believes that contractual provisions that attempt to change or waive rules of evidence or fix the method or quantum of proof to be applied in litigation or similar proceedings are not included within the equitable principles limitation, and therefore, an opinion giver would customarily disclaim separately any opinion regarding their enforceability. The Subcommittee recommends that the exception be stated as follows:

We express no opinion with respect to the enforceability of Section __ of [the Agreement] [(if necessary for clarity:) as it relates to [rules of evidence] [or] [issues of] [quantum of proof].

12. **APPOINTMENT OF RECEIVER.** This was identified in 1992 as a California Qualification. Cal. Code Civ. Proc. § 564 governs the appointment of a receiver under California law. If the subject matter of the agreement in which a contractual provision providing for the appointment of a receiver is specified under Cal. Code Civ. Proc. § 564 as a circumstance when a “receiver may be appointed”, the provision will, as a matter of law, be enforceable in that the court will have the capacity to implement the remedy. *Id.* The appointment of a receiver, however, is an equitable remedy that remains subject to the equitable discretion of the court in light of all relevant factual circumstances. It is a unique remedy that requires substantial judicial intervention. *U.S. Overseas Airlines v Alameda County*, 235 Cal. App. 2d 348, 353 (1965) (“[a] receiver is an officer or representative of the court appointed to take charge of and manage property which is subject to litigation, for the purpose of preserving it and ultimately disposing of it pursuant to final judgment.”). Additionally, the appointment of a receiver can adversely affect the business practices and relationships of interested parties. See, e.g., *Superior Motels, Inc. v. Rinn Motor Hotels, Inc.*, 195 Cal. App. 3d 1032, 1052 (1987) (“The appointment of a receiver often entails drastic disruptive consequences to existing business relationships.”); *Rogers v. Smith*, 76 Cal. App. 2d 16, 21 (1946) (“[r]eceivership is an extraordinary remedy to be applied with caution and only in cases of apparent necessity, where other remedies would be inadequate”).

As with covenants not to compete (*supra*, endnote 2), the Subcommittee believes that, given existing restrictions on the power of a court to appoint a receiver, it is customary for California firms to disclaim any opinion regarding the enforceability of a provision for the appointment of a receiver. Such a disclaimer might read as follows:

We express no opinion with respect to the effect of California Code of Civil Procedure § 564 on the enforceability of [Section __ of the [Agreement]].

13. FORUM SELECTION CLAUSES AND CONSENTS TO JURISDICTION.

A consent to personal jurisdiction is enforceable if “freely negotiated” and not “unreasonable and unjust.” *Burger King v. Rudzewicz*, 105 S. Ct. 2174 (1985).

A non-exclusive forum selection clause is subject to considerations of forum non-conveniens. However, because there is nothing to enforce in a non-mandatory clause (except to the extent that it includes a consent to personal jurisdiction), there is no need for an exception. *Docksider, Ltd. v. Sea Technology, Ltd.*, 875 F. 2d 762 (9th Cir. 1989) (language that a particular court “shall have jurisdiction” treated as permissive and not mandatory, permitting venue in

other locations). A mandatory or exclusive forum selection clause is enforceable in the absence of unreasonableness or serious inconvenience where the other party has notice of the provision. *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1 (1972); *Carnival Cruise Lines v. Shute*, 499 U.S. 585 (1991); *Smith, Valentino & Smith, Inc. v. Superior Court*, 17 Cal. 3d 491 (1976); *Hall v. Superior Court*, 150 Cal. App. 3d 411 (1983); *Lifeco Services Corp. v. Superior Court*, 222 Cal. App. 3d 331 (1990); *CQL Original Prods., Inc. v. National Hockey League Players Ass'n*, 39 Cal. App. 4th 1347 (1995); *Intershop Communications, AG v. Superior Court (Martinez)*, 104 Cal. App. 4th 191 (2002) (mandatory clause unenforceable only if unreasonable). Because the Bremen exception is so narrow, an exception is ordinarily not required.

If California law is chosen to govern an agreement that involves at least \$1,000,000, Cal. Code Civ. Proc. Section 410.40 provides that a choice of California as the forum for litigation will be enforced:

Any person may maintain an action or proceeding in a court of this state against a foreign corporation or nonresident person where the action or proceeding arises out of or relates to any contract, agreement, or undertaking for which a choice of California law has been made in whole or in part by the parties thereto and which (a) is a contract, agreement, or undertaking, contingent or otherwise, relating to a transaction involving in the aggregate not less than one million dollars (\$1,000,000), and (b) contains a provision or provisions under which the foreign corporation or nonresident agrees to submit to the jurisdiction of the courts of this state.

A forum selection clause, however, is not enforceable where it has the effect of waiving important rights. *America Online, Inc. v. Superior Court*, 90 Cal. App. 4th 1 (2001). The exception on the waiver of important rights would cover this possibility.

Venue selection clauses (*i.e.*, those that attempt to prescribe the actual court in which an action must be brought—for example, a requirement that any action be commenced in the California state court located in a specified county), unlike forum selection clauses, are not enforceable. *Alexander v. Superior Court*, 114 Cal. App. 4th 723 (2003).

14. PROVISIONS APPOINTING AN ADVERSE PARTY AS ATTORNEY IN FACT. This was identified in 1992 as a California Qualification, and, historically, contractual provisions pursuant to which a borrower appoints a lender as its attorney in fact have been viewed with skepticism because of the adverse relationship between borrower and lender. See, e.g., Joint Committee of the Real Property Law Section of the State Bar of California and the Real Property Section of the Los Angeles County Bar Association, Legal Opinions in California Real Estate Transactions, 42 Bus. Law. 1139, 1160 n.47 (1987) (“... some loan documents contain provisions in which the borrower purports to appoint the lender as the borrower’s ‘attorney-in-fact.’ Even if such appointment is stated to be a ‘power coupled with an interest,’ it is highly unlikely the power could be validly exercised as a remedy following default.”)

No case law is cited for the foregoing proposition, however, and recent authority suggests that such provisions are enforceable. Bankruptcy cases support a lender’s right to execute financing statements on the borrower’s behalf under the terms of the underlying loan

documentation. *See In re Grieb Printing Co.*, 230 B.R. 539 (Bankr. W.D.Ky. 1999) (lender's signature on a financing statement as borrower's attorney in fact was valid where borrower had expressly authorized lender to sign financing statements on its behalf). *See also In re Goolsby*, 284 B.R. 638 (M.D. Tenn. 2002) (lender's signature on a financing statement as borrower's attorney in fact was invalid where lender failed to indicate the source of its signing authority, not because it lacked the right to sign on borrower's behalf). Likewise, despite basic agency principles that might seem to indicate to the contrary (e.g., 3 Am.Jur.2d, Agency § 237 (the law of principal and agent generally provides that an agent cannot act in a way that is contrary to the best interests of the principal, absent fully informed consent); 2 Witkin Sum. Cal. Law, Agency § 41 (an agent is required to disclose to the principal all information he has relevant to the subject matter of the agency)), California courts have endorsed the concept of making an adverse party one's agent. *See, e.g., Michelson v. Hamada*, 29 Cal. App. 4th 1566, 1579 (1994) (holding that any person may be authorized to act as an agent, including an adverse party to a transaction). Such limitations as may be imposed by California law on the enforceability of appointments of attorneys-in-fact are best characterized as falling within the equitable principles limitation.

15. WAIVERS OF RIGHTS TO JURY TRIALS. This was not identified in 1992 as a California Qualification, but many California opinion givers have included this exception in their opinions, and a recent case (now on appeal) makes enforceability problematic.⁶

For over a decade, the leading case with respect to waivers of jury trials in commercial contracts was *Trizec Properties, Inc. v. Superior Court*, 229 Cal. App. 3d 1616 (1991), in which a jury trial waiver set forth in a commercial lease agreement was held to be enforceable. The court discussed the possible application of Cal. Code Civ. Proc. § 631 (which provides that a party may waive a jury trial by "written consent filed with the clerk or judge" (§ 631(d)(2)) and which also provides that "the court may, in its discretion upon just terms, allow a trial by jury although there may have been a waiver of a trial by jury" (§ 631(d))), citing *Madden v Kaiser Foundation Hospitals*, 17 Cal. 3d 699 (1976) (upholding an arbitration clause), but concluded that Cal. Code Civ. Proc. § 631 presupposes a pending action, and "since the waiver was entered into prior to the filing of any action, Code of Civil Procedure § 631 is inapplicable to the facts of this case." The court went on to state that "Article I, § 16 of the California Constitution cannot be read to prohibit individuals from waiving, in advance of any pending action, the right to trial by jury in a civil case." (The *Trizec* court cautioned that "[w]e do not mean to imply that contractual waivers of trial by jury will be upheld in all instances, or that such rights will be taken away from a party who unknowingly signs a document purporting to exact a waiver. The right to trial by jury in a civil case is a substantial one not lightly to be deemed waived. On the other hand, in many commercial transactions advance assurance that any disputes that arise will be subject to expeditious resolution in a court trial would best serve the needs of the contracting parties as well that of our overburdened judicial system. ... [T]o be enforceable, the waiver

⁶ Literally, the enforceability of a waiver of a right to jury trial, since it constitutes a waiver of a constitutional right, would be covered by the exception discussed in endnote 6, *supra*. As a matter of customary usage, however, that exception, which is stated very broadly, is not understood to encompass jury trial waivers; rather, opinion givers wishing to qualify a remedies opinion with respect to such waivers customarily include a separate exception to that effect.

provision must be clearly apparent in the contract and its language must be unambiguous and unequivocal, leaving no room for doubt as to the intention of the parties.” *Trizec Properties*, 229 Cal. App. 3d. at 1619.)

In February, 2004, however, the First Appellate District of the Court of Appeal, in *Grafton Partners v. Superior Court*, 115 Cal. App. 4th 700 (2004), hearing granted by California Supreme Court, declared that *Trizec* was wrongly decided, holding that Code of Civil Procedure § 631 is “the sole means for selecting a court rather than a jury trial in a civil case.” Citing comments made during the [California] Constitutional Convention of 1878-1879, during which it was proposed—and rejected--that parties be given “the express power to waive a jury, or to make a jury waiver subject to judicial approval,” the *Grafton* court concluded that “California constitutional history reflects an unwavering commitment to the principle that the right to a jury trial may be waived only as the Legislature prescribes, even in the face of concerns that the interests of the parties and the courts would benefit from a relaxation of this requirement”—and, accordingly, that a contractual predispute jury waiver in a civil action is not enforceable under California law.

In light of the *Grafton* case (at least until the California Supreme Court renders its opinion), the Subcommittee believes that it would be appropriate—and that it will become customary practice--for an opinion giver to include an exception with respect to a jury trial waiver provision contained in a commercial contract. Sample language follows:

We express no opinion with respect to the enforceability of Section ___ of [the Agreement].

16. PROVISIONS STATING THAT REMEDIES ARE CUMULATIVE. Provisions to the effect that a party’s remedies (and rights) are cumulative are often found in loan agreements and other contexts, and are considered boilerplate in certain areas of practice. Remedies under Division 9 of the California Uniform Commercial Code are cumulative. Cal. UCC § 9601(c). Provisions providing in other contexts that remedies are cumulative, however, can be of questionable enforceability: the general rule in California is that multiple remedies in a single cause of action are allowed as long as the remedies are (a) not mutually exclusive and (b) legally consistent. (Witkin, 4 California Procedure (4th) Edition, Pleading, § 370.) Inconsistent remedies are subject to the election of remedies doctrine, which acts as a bar to preclude a plaintiff from seeking a remedy that is inconsistent with its prior conduct or election. The enforceability of cumulative remedies provisions may also be affected by California law limiting the remedies that can be sought in certain contexts (for example, real estate secured transactions), including (x) the “one form of action rule” of Cal. Code Civ. Proc. § 726 and the anti-deficiency and fair value statutes of Sections 580a-d of the California Code of Civil Procedure, for loans secured by real property, (y) guarantor-related defenses (see endnote 18), and (z) marshalling requirements for property secured by a lien.⁷ When an opinion is rendered in respect of an

⁷ See, generally, Cal. Civ. Code Sections 2899 (which establishes the order in which a holder of liens on multiple properties must resort to its security when other parties have subordinate liens on some, but not all, of the properties), and 3433 (which provides the holder of a such a subordinate lien the right to require the senior creditor to seek satisfaction from property that is not subject to the subordinate lien, provided that the senior creditor is not

agreement that includes both a cumulative remedies provision and remedies that are mutually exclusive or not legally consistent, or that are subject to the cited provisions of California law, a specific exception with respect to the relevant provision is appropriate. (The 1987 Real Property Report suggested that a lawyer need not disclose limitations or exceptions to the enforcement of obligations that arise out of boilerplate provisions, such as provisions to the effect that all remedies are cumulative (42 Bus. Law. 4, 1139, 1166); the Subcommittee believes, however, that California lawyers customarily point out the limitations on cumulative remedies inherent to real-property secured transactions under California law, and that, especially where counsel to the opinion recipient is not qualified in California, an opinion giver should consider separately identifying remedies that are mutually exclusive.

Transactions involving real property security are beyond the scope of this appendix. To the extent that marshalling principles apply outside that context, the Subcommittee notes that marshalling is an equitable doctrine “developed historically and traditionally used to prevent a junior lienholder with a security interest in a single property from being squeezed out by a senior lienholder with a security interest not only in that property, but in one or more additional properties” *Shedoudy v. Beverly Surgical Supply Co.*, 100 Cal. App. 3d 730 (1980). As a result, uncertainty regarding the enforcement of cumulative remedy provisions in this area should be covered by the equitable principles limitation.

The Subcommittee suggests that, where appropriate, an exception be included. The following is a sample:

[We express no opinion regarding the enforceability of [Section ____] of the [Agreement].

17. PROVISIONS STATING THAT THE PROVISIONS OF A CONTRACT ARE SEVERABLE. California courts are required by Cal. Civ. Code §§ 1599, 1643 and 1670.5(a) to interpret contracts in a manner that gives the contracts effect rather than making them void. As a general matter, enforcing severability provisions would comport with these requirements, but not every provision of a contract is automatically severable. Courts need to consider the entirety of a contract to determine whether any particular provision is severable, and the enforceability of a severability provision is highly dependent upon the specific circumstances in which enforcement of the provision is sought; “a contract may be severable as to some of its terms, or for certain purposes, but indivisible as to other terms, or for other purposes.” *Simmons v. California Institute of Technology*, 34 Cal. 2d 264, 275 (1949). Even where contractual provisions that are illegal, unconscionable, or against public policy are not enforced, the courts tend to follow the preference, under the California statutory regime and under case law, for interpreting contracts in a manner that gives them effect. See, e.g., *County of Marin v. Assessment Appeals Bd.*, 64 Cal. App. 3d 319, 325 (1976) (applying Cal. Civ. Code § 1643.) If the contract is severable, a provision may be rescinded in equity, provided that no injustice is done as a result. *Simmons*, 34 Cal. 2d, at 275-76.

harmful by doing so). As noted in the text, *infra*, however, transactions involving real property security are beyond the scope of this appendix.

Given this standard, the Subcommittee believes that provisions to the effect that a contract is severable are generally enforceable, and need not be made the subject of a separate exception. *See, however*, the discussion of provisions requiring the arbitration of disputes, *infra* at endnote 20.

18. PROVISIONS WAIVING DEFENSES OF GUARANTORS. In California there are several statutes that provide the guarantor with important rights and protections, primarily Cal. Civ. Code §§ 2787-2855. Some of the statutory protections are:

(i) The obligations of the guarantor may not be any more burdensome than the obligations of the principal (Cal. Civ. Code § 2809).

(ii) The guarantor can compel the creditor to proceed first against the principal or any collateral (Cal. Civ. Code §§ 2845 and 2850) and can compel the principal to pay the guaranteed obligation (Cal. Civ. Code § 2846), and is subrogated to the rights of the creditor upon payment of the guaranteed obligations (Cal. Civ. Code §§ 2848 and 2849).

(iii) The guarantor is exonerated if the principal is released without the consent of the guarantor (Cal. Civ. Code § 2810), if the principal's remedies against the principal are impaired or if the guaranteed obligation is modified without the guarantor's consent (Cal. Civ. Code § 2819).

In addition there are other rights provided to a guarantor under the California Uniform Commercial Code, where the guarantor is defined as an "obligor" (Cal. UCC § 9102) and has the rights and defenses available to a debtor under Division 9 of the California Uniform Commercial Code.

California courts have recognized that the various Civil Code defenses and rights can be waived by a guarantor. (*Pearl v. General Motors Acceptance Corp.*, 13 Cal. App. 4th 1023 (1993), referring to Cal. Civ. Code 2815; *Brunswick Corp. v. Hays*, 16 Cal. App. 3d 134 (1971), referring to Cal. Civ. Code §§ 2845 and 2849; *Union Bank v. Ross*, 54 Cal. App. 3d 290 (1976), referring to Cal. Civ. Code §§ 2819 and 2845.) They have, however, differed on the precise language that is adequate to constitute a waiver of the guarantor's defenses. Starting from the proposition that the waiver documents would be interpreted most strongly against the creditor and all ambiguities would be interpreted against the creditor (*Pearl v. General Motors Acceptance Corp.*, 13 Cal. App. 4th 1023 (1993)), courts have held that, in the absence of an *explicit* waiver, they would not find a waiver by implication (*Union Bank v. Gradsky*, 265 Cal. App. 2d 40 (1968); *Cathay Bank v. Lee*, 14 Cal. App. 4th 1533 (1993)). Other courts went further and held that the guaranty must contain a specific description of the rights being waived. (*Torrey Pines Bank v. Hoffman*, 231 Cal. App. 3d 308 (1991)) or that the specific statutory provisions being waived must be expressly identified. *Mariners Savings and Loan Ass'n v. Neil*, 22 Cal. App. 3d 232 (1971); *Indusco Management Corp. v. Robertson*, 40 Cal. App. 3d 456 (1974). A general waiver of all suretyship defenses was not sufficient. (*Pearl v. General Motors, supra*.)

In 1994, Cal. Civ. Code § 2856 was enacted, authorizing waivers of a guarantor's various rights and defenses. The purpose of the amendment was to establish a standard for waivers that

was less stringent than that established by the *Cathay Bank* decision (*see River Bank America v. Diller*, 38 Cal. App. 4th 1400 (1995)). However, in *Bank of Southern California v. Dombrow*, 39 Cal. App. 4th 1457 (later decertified) the Court of Appeals held that the waiver was not sufficiently clear and continued the practice of imposing a stringent standard on guarantor waivers.

In 1996, a revised version of Cal. Civ. Code § 2856 was enacted. The language in Cal. Civ. Code § 2856 is clear on its face, and may eliminate any more exacting standards of specificity required by previous case law. (*See River Bank America v. Diller*, 38 Cal. App. 4th 1400 (1995) (stating that “[I]n apparent response to *Cathay Bank*’s strict holding, the Legislature enacted section 2856.”). There have been few decisions addressing the provision, however, and a recent case that considered the extent of a guaranty, *Conner v. Conner* 76 Cal. App. 4th 646 (1999), did not address Cal. Civ. Code § 2856 at all, but instead reached its decision by balancing the expectations of the guarantor and the creditor.

In addition, the reported legislative intent behind Cal. Civ. Code § 2856 has left open an opportunity for confusion. The statement of legislative intent that accompanies § 2856 states: “[s]ubdivisions (a) and (b) of Section 2856 of the Civil Code do not represent a change in, but are merely declarative of, existing law” Stats. 1994 § 2, c. 1204 (A.B.3101; *emphasis added*). Even though the statute is widely understood to have been intended to overrule certain cases that had required ever-more-explicit expressions of an intent to waive defense—as is clear from those portions of it that state that no particular language or phrase need be included for a waiver to be effective, it could be argued that the statement of legislative intent weakens the authority of Section 2856 by carving out exceptions for prior holdings that required a higher standard to be met when attempting to waive a guarantor’s defenses and creates an overlay of equitable principles. *See Cathay Bank*, 14 Cal. App. 4th at 1533; *Indusco*, 40 Cal. App. 3d at 461-2.⁸

The foregoing cases address only a guarantor’s rights under the California Civil Code; they do not address a guarantor’s rights as an obligor under the California Uniform Commercial Code, which explicitly prohibits advance waivers of certain rights.

As a result of these factors, even though waivers of a guarantor’s rights and defenses (subject to certain statutory exceptions that would be covered by the exception for waivers of statutory rights that is endorsed in endnote 6, *supra*), are generally enforceable, California opinion givers have in the past customarily declined, and continue customarily to decline, to render an opinion as to sufficiency of any specific waiver of those rights and defenses.⁹ While it is reasonable to expect that future courts will follow the mandate of Cal. Civ. Code § 2856 and

⁸ Section 2856 includes “safe harbor” forms of waivers of certain defenses that incorporate references to specific statutes. Some practitioners have expressed concern that a court might not give effect to waiver that does not cite those statutes, despite the Section’s clear statement to the effect that no such references are necessary.

⁹ In the recent case *Pacific State Bank v. Greene* 110 Cal. App. 4th 375 (2003), the California Court of Appeals for the 3d District allowed a guarantor to introduce parol evidence relating to the scope of the guaranty and the parties’ intent with respect thereto, even though the Appellate Court found that the language of the guaranty was clear and unambiguous. The *Pacific State Bank* decision could allow a guarantor to introduce parol evidence relating to the scope of the waiver language. (The Subcommittee notes, however, that the opinion giver is not responsible for parol evidence that changes the plain meaning of the agreement.)

give effect to waivers of suretyship defenses, the paucity of controlling authority applying Section 2856 has led the Subcommittee to conclude that there remains a sufficient degree of uncertainty as to the enforceability of particular forms of waiver that an exception with respect to the enforceability of such waivers should, as a matter of customary practice, continue to be accepted by opinion recipients. The following sample language is modeled on the suggested form contained in 1987 Real Property Report, with some updating of the statutory and case law references:

We advise you of California statutory provisions and case law to the effect that a guarantor may be discharged, in whole or in part, if the beneficiary of the guaranty alters the obligation of the principal, fails to inform the guarantor of material information pertinent to the principal or any collateral, elects remedies that may impair either the subrogation or reimbursement rights of the guarantor against the principal or the value of any collateral, fails to accord the guarantor the protections afforded a debtor under Division 9 of the [California Uniform Commercial Code] or otherwise takes any action that prejudices the guarantor, unless, in any such case, the guarantor has effectively waived such rights or the consequences of such action or has consented to such action. *See, e.g.,* California Civil Code §§ 2799 through Section 2855; California Uniform Commercial Code § 9-602, *Sumitomo Bank of California v. Iwasaki*, 70 Cal. 2d 81, 73 Cal. Rptr. 564 (1968); *Union Bank v. Gradsky*, 265 Cal. App. 2d 40, 71 Cal. Rptr. 64 (1968). While California Civil Code Section 2856, and case law, provide that express waivers of a guarantor's right to be discharged, such as those contained in the [Guaranty], are generally enforceable under California law, we express no opinion with respect to the effectiveness of the waivers in the [Guaranty].

19. PROVISIONS LIMITING RIGHTS TO CURE, WITHOUT CONSIDERING MATERIALITY. This is based upon one of the components of the Accord's definition of the equitable principles limitation. The Subcommittee's research revealed no cases dealing exactly with this issue. There are, however, a number of statutory provisions, cases and principles dealing with provisions that embody essentially the same principle. These include time is of the essence clauses (discussed *supra*, at endnote 4), provisions providing for penalties or forfeitures for delayed performance (discussed *supra*, at endnote 3), and similar provisions otherwise phrased, which indicate that a provision limiting a party's right to cure, without considering the materiality of the breach, would be treated the same way by the courts: that is, the provision is sometimes enforced, and sometimes not. The outcome is governed by equitable principles.

A right to cure is a mechanism generally available to a breaching party to a contract as a means to lessen the harsh impact of other contract principles, such as the perfect tender rule (a contract principle that affords the buyer the right to reject the goods from a seller if the "quality, quantity, or delivery of the goods fails to conform precisely to the contract." Black's Law Dictionary 1158 (7th ed. 1999)). Notwithstanding the general right to cure (*see below*), parties may include contractual provisions that purport to waive or limit that right. These provisions can take various forms; contractual provisions having the effect of waiving a party's right to cure are generally expressed in the form of affirmative provisions or clauses, such as penalty or forfeiture clauses and terms indicating that "time is of the essence," rather than as a negative clause that

waives outright any right to cure. The enforceability of these provisions depends in large part on the type of provision that is actually being invoked, but, as discussed below, would be rare except where the aggrieved party would be materially harmed by affording such a right to the breaching party.

As explained in endnote 4, *supra*, time of the essence provisions are not automatically enforced. They are subject to a great deal of scrutiny by the courts. This is because courts do not favor forfeitures, including penalties. As a result, such provisions and others of similar effect are not enforced where the obligee has contributed to the default or, in an installment payment default, has given some indication of not seeking a forfeiture for nonpayment on time. Under such circumstances the courts have relied on equitable principles, such as waiver and estoppel and even “just plain” equitable treatment of the parties, to prevent a forfeiture. Whether or not a court will find that a waiver exists or that a party should be estopped depends entirely on the inequity of the forfeiture. This requires the court to take into account the nature and amount of the forfeiture, the actual time and effect on the aggrieved party of delay in performance, the amounts involved, and whether the compensation in general was reasonable.

It should be noted that forfeiture as a consequence of untimely performance where time is provided to be of the essence is not the same as having an independent forfeiture provision in the contract. Indeed, a valid contract may contain both types of provisions. *See MacFadden v. Walker*, 5 Cal. 3d 809 (1971) (contract contained both time of the essence clause and a provision for forfeiture on default); *see also Williams Plumbing, Co. v. Sinsley*, 53 Cal. App. 3d 1027 (1975). But, because forfeitures are not favored, California law provides various mechanisms to avoid outright forfeiture provisions, however phrased. *See Ells v. Order of United Commercial Travelers of Am.*, 20 Cal. 2d 290 (1942); *see also* Cal. Civ. Code § 3275:

RELIEF IN CASE OF FORFEITURE. Whenever, by the terms of an obligation, a party thereto incurs a forfeiture, or a loss in the nature of a forfeiture, by reason of his failure to comply with its provisions, he may be relieved therefrom, upon making full compensation to the other party, except in case of a grossly negligent, willful, or fraudulent breach of duty.

Under this Section, a provision for forfeiture must be clear, but the court will attempt, by construction, to avoid it where enforcement would lead to inequitable results. *See Nelson v. Schoettgen*, 1 Cal. App. 2d 418, 423 (1934); *see also Universal Sales Corp. Ltd. v. California Press Mfg. Co.*, 20 Cal. 2d 751, 771 (1942). Notwithstanding the equitable principles underlying Section 3275, its rule is not without limitation. “It is true that the law looks with disfavor upon forfeitures . . . but this does not mean that the courts may make for the parties a different contract from what they have agreed upon or resort to a strained and unnatural construction to defeat or nullify their clearly expressed purpose or intention.” *See Troughton v. Eakle*, 58 Cal. App. 161, 173 (1922). This rule has been applied in various situations, including foreclosures, real property sales, construction contracts, quieting title, insurance, and leases, as well as to contracts for the sale of personalty. In most situations, the court has granted relief to the defaulting party after balancing the equities in light of the facts and circumstances in order to avoid harsh results.

The Subcommittee believes that provisions that prohibit the consideration of the materiality of a failure to perform attempt to undercut equitable principles themselves, and are properly classified as falling within the scope of the equitable principles limitation.

20. PROVISIONS REQUIRING ARBITRATION OF DISPUTES ARISING OUT OF TRANSACTION. In California, an arbitration agreement generally is valid, irrevocable, and enforceable. Cal. Code Civ. Proc. § 1281 (Deering 2004); and see 9 U.S.C. §§ 1, 2 (governing arbitration agreements under federal law); *Armendariz v. Foundation Health Psychcare Services, Inc.*, 24 Cal. 4th 83, 97-99 (2000). Nevertheless, an arbitration agreement, or portions of it, may be limited or found invalid in three types of situations.

First, at least in certain labor cases, California courts will subject an arbitration agreement to particular scrutiny and impose additional minimum requirements: (i) when non-waivable statutory rights are at stake (*Armendariz*, 24 Cal. 4th at 100); and (ii) in "Tameny claims" where an employee alleges wrongful termination in violation of public policy (*Little v. Auto Stiegler, Inc.*, 29 Cal. 4th 1064, cert. denied, 124 S. Ct. 83 (2003)). *Armendariz* articulated these minimum requirements with regard to a mandatory arbitration agreement involving non-waivable statutory rights of an employee: (1) the agreement must provide for a neutral arbitrator; (2) the agreement may not limit remedies to less than that which the employee would be entitled to recover under the applicable statute; (3) adequate discovery must be provided so that the employee may vindicate any statutory claim; (4) the award must be detailed enough to reveal the essential findings and conclusions on which it is based so that some judicial review may be performed; and (5) there must be limitations on the costs of arbitration an employee may be required to bear. *Armendariz*, 24 Cal. 4th at 102-03. *Little* provided that the minimum requirements set forth in *Armendariz* should likewise apply to a claim of wrongful termination of employment in violation of public policy. *Little*, 29 Cal. 4th at 1076.

Second, an arbitration agreement may be found invalid if it is not enforceable under traditional contract law principles, e.g., if unconscionable. Although normally the consideration of unconscionability in the opinion context would address these issues, a distinct body of unconscionability law has developed in the context of arbitration agreements. *Mercurio v. Superior Court*, 96 Cal. App. 4th 167 (2002) (finding a requirement that an employee pay an equal share of the costs of arbitration was per se unconscionable); *Szetela v. Discover Bank*, 97 Cal. App. 4th 1094 (2002) (finding an arbitration agreement unconscionable where that agreement prohibited class actions, noting that the unconscionability analysis has both a procedural and a substantive element); *Abramson v. Juniper Networks, Inc.*, 115 Cal. App. 4th 638 (2004) (finding a requirement that employee and employer arbitrate all claims except intellectual property claims to be substantively unconscionable for lack of mutuality, it being designed to protect only the employer's interests); *Armendariz*, 24 Cal. 4th at 113 (holding that the multiple defects of an unlawful damages provision and a unilateral arbitration clause weigh against restricting the agreement and weigh instead in favor of striking the entire arbitration agreement); see also *Blake v. Ecker*, 93 Cal. App. 4th 728, 742 (2001) (directing the lower court in an employment dispute to consider first whether the terms of arbitration were part of an adhesive contract and, second, whether those terms were unconscionable); *Bolter v. Superior Court*, 87 Cal. App. 4th 900 (2001) (finding mandatory arbitration in a non-U.S. jurisdiction unconscionable); *Flores v. TransAmerica HomeFirst Inc.*, 93 Cal. App. 4th 846 (2001) (finding a

unilateral obligation to arbitrate contained in a loan agreement that constituted an adhesion contract to be so one-sided “as to be substantively unconscionable”); *Pinedo v. Premium Tobacco Stores, Inc.*, 85 Cal. App. 4th 774 (2000) (deeming an agreement unconscionable because of its limitation on damages, its preclusion of recovery on certain claims, its denial of attorneys’ fees even where the employee prevails, and its cost-shifting provision). However, the application of an unconscionability analysis may not necessarily result in striking down all restrictive arbitration provisions. *See, e.g., Mercuro*, 96 Cal. App. 4th at 182-84 (suggesting that very restrictive discovery terms of arbitration agreement were not per se unconscionable but striking down the agreement for unconscionability on other grounds). Further, the existence of an unconscionable provision need not be fatal to the enforceability of the arbitration agreement. Cal. Civ. Code Section 1670.5 authorizes a court, in its discretion, either to refuse to enforce a contract if it finds as a matter of law the contract or any clause thereof to be unconscionable at the time it was made, or to enforce the contract without the unconscionable clause. *Armendariz* noted that a single unconscionable term could justify striking down an arbitration agreement, if that term was drafted in bad faith. *Armendariz*, 24 Cal. 4th at 124-25, n. 13. More recently, one court has instructed that the proper analysis to be conducted with regard to arbitration agreements with an unconscionable provision is to evaluate the clarity of the law at the time of the signing of the agreement to determine if the unconscionable provision was drafted in bad faith, and then to exercise its discretion as to whether to sever that provision. *Gutierrez v. Auto West, Inc.*, 114 Cal. App. 4th 77 (2003) (involving a provision requiring automobile lease consumers to pay substantial administrative fees in connection with bringing an arbitration proceeding).

Third, an arbitration agreement may be found to be invalid if it purports to override or contravene a provision of the California Arbitration Act enacted primarily for a public purpose. For example, a decision under an agreement providing for arbitration in accordance with the former American Arbitration Association construction industry dispute resolution rules was vacated when those rules governing the circumstances under which an arbitrator should be disqualified were invoked to override the mandatory disqualification rights offered by § 1281.91(b)(1) of the California Code of Civil Procedure. *See Azteca Construction, Inc. v. ADR Consulting, Inc.*, 121 Cal. App. 4th 1156, 1166-68 (2004) (provisions for arbitrator disqualification established under the California Arbitration Act may not be waived or suspended by a private contract).¹⁰ Similarly, an arbitration agreement that provides for judicial review of an arbitration award on the merits may be found invalid inasmuch as it improperly expands the scope of judicial review beyond the grounds specifically enumerated in §§ 1286.2 and 1286.6 of the California Code of Civil Procedure. *See Crowell v. Downey Community Hospital Foundation*, 95 Cal. App. 4th 730, 739-40 (2002) (invalidating an entire arbitration agreement where the judicial review provisions were central and not severable from the agreement); *cf.*

¹⁰ The Subcommittee notes that a remedies opinion is not customarily understood to address the risk that a court will not enforce the rules of any arbitration tribunal that are selected to govern arbitration. As noted by the TriBar Report, at § 3.6.2:

Agreements that contain arbitration provisions usually incorporate by reference the rules of an arbitral tribunal (e.g., ‘any dispute is to be determined in accordance with the Commercial Arbitration Rules of the American Arbitration Association’). While the remedies opinion addresses the enforceability of the arbitration provision, as a matter of customary usage the remedies opinion is understood not to address the enforceability of these rules.

Oakland - Alameda County Coliseum Authority v. CC Partners, 101 Cal. App. 4th 635 (2002) (severing the invalid judicial review provisions from the valid arbitration agreement).

The first of these three circumstances is addressed by the specific exception endorsed in endnote 6, *supra*. The second is addressed, to some extent, by the discussion of unconscionability in endnote 28, *infra*. Where the third circumstance exists, the Subcommittee believes that an appropriate exception should be taken. This recommendation is consistent with the 1989 Report, which stated (at ¶ V.C.2) that an opinion giver should include an exception with respect to an arbitration provision “only where the [opinion giver] has a specific concern regarding the enforceability of an arbitration provision in the particular transaction.”

Sample language of exception:

We advise you that a court may refuse to enforce [Section __ of the Agreement], which provides [for judicial review of arbitration awards/other appropriate reason]. We express no opinion with respect to the effect of the inclusion of that provision in [the Agreement] upon the enforceability of the parties’ agreement to submit disputes to arbitration.

21. PROVISIONS LIMITING THE AWARD OF ATTORNEYS’ FEES. California opinion givers commonly include a reference to Cal. Civ. Code § 1717 (a portion of which is stated below), which expressly alters the effect of contractual provisions that state that fewer than all parties to the contract are entitled to recover attorneys’ fees and expenses. In any action on a contract with such a provision, the statute allows any party who is subsequently judicially determined to be the prevailing party on the contract also to be entitled to reasonable attorneys’ fees, in addition to other costs, even if not so specified by the contract. Therefore, an attorney’s fee provision purporting to benefit fewer than all parties to the contract, though not invalid, would not be enforceable in accordance with its terms under California law. Rather, it must be treated as benefiting any party who is the “prevailing party”. Section 1717 is not an attempt to codify equitable principles, since fee provisions benefiting one party are generally fully enforceable under general contract law, although fairness to all parties clearly is the intent underlying Section 1717, and the statutory change in contract law could be said to be derived from equitable principles.

According to the California Supreme Court, “The primary purpose of Section 1717 is to ensure mutuality of remedy for attorney fee claims under contractual attorney fee provisions.” *Santisas v. Goodwin*, 17 Cal. 4th 599, 610 (1998). Without Section 1717, provisions benefiting one party would be construed according to standard principles of contract law, resulting in a significant advantage to those parties with superior bargaining strength if litigation arises or threatens to arise under the contract. The Supreme Court noted the potential for unfairness inherent in such provisions when it stated that Section 1717 helped “to prevent oppressive use of one-sided attorney’s fees provisions.” *Reynolds Metals Co. v. Alperson*, 25 Cal. 3d 124, 128 (1979). Therefore, the statute reflects a legislative decision to alter the common-law rules of contract construction in favor of a public policy designed to protect those “who may be in a disadvantageous contractual bargaining position.” *Int’l Billing Services, Inc. v. Emigh*, 84 Cal. App. 4th 1175, 1188 (2000) (internal quotation marks omitted).

California Civil Code § 1717(a):

1717. (a) In any action on a contract, where the contract specifically provides that attorney's fees and costs, which are incurred to enforce that contract, shall be awarded either to one of the parties or to the prevailing party, then the party who is determined to be the party prevailing on the contract, whether he or she is the party specified in the contract or not, shall be entitled to reasonable attorney's fees in addition to other costs.

Where a contract provides for attorney's fees, as set forth above, that provision shall be construed as applying to the entire contract, unless each party was represented by counsel in the negotiation and execution of the contract, and the fact of that representation is specified in the contract.

Reasonable attorney's fees shall be fixed by the court, and shall be an element of the costs of suit.

Attorney's fees provided for by this section shall not be subject to waiver by the parties to any contract which is entered into after the effective date of this section. Any provision in any such contract which provides for a waiver of attorney's fees is void.

Sample language of exception:

The enforcement of Section ___ of [the Agreement] is subject to the limitations of Section 1717 of the California Civil Code.

22. PROHIBITIONS OF ORAL MODIFICATIONS. Cal. Civ. Code § 1698 ("Section 1698") states:

- (a) A contract in writing may be modified by a contract in writing.
- (b) A contract in writing may be modified by an oral agreement to the extent that the oral agreement is executed by the parties.
- (c) Unless the contract otherwise expressly provides, a contract in writing may be modified by an oral agreement supported by new consideration. The statute of frauds (Section 1624) is required to be satisfied if the contract as modified is within its provisions.
- (d) Nothing in this section precludes in an appropriate case the application of rules of law concerning estoppel, oral novation and substitution of a new agreement, rescission of a written contract by an oral agreement, waiver of a provision of a written contract, or oral independent collateral contracts.

Section 1698(d) has traditionally been understood to codify equitable principles. Accordingly, the 1992 Report deemed it unnecessary to separately state an exception relating to contractual provisions that purport to prohibit oral modifications, as the circumstances in which they would

not be enforced fall within the equitable principles limitation. 1992 Report, § III.F. The Subcommittee endorses the approach of the 1992 Report.

23. INDEMNITY/EXCULPATION OF A PARTY IN RESPECT OF ITS OWN MISCONDUCT. The 1989 Report (at ¶ V.C.1) noted the reluctance of California courts “to enforce provisions requiring one party to indemnify another party for loss or damage resulting in part from the second party’s wrongful or negligent acts.” While express contractual provisions indemnifying (or purporting to release or exculpate) a party for damages arising out of its own negligence or misconduct have generally been held to be enforceable under recent California law, the traditional “general rule” that a party will not be indemnified for its own active negligence under a “general” indemnity agreement has not been wholly abandoned in the most recent cases addressing this issue. The result is that while acknowledging the enforceability of express indemnification provisions, the courts subject them to strict judicial scrutiny as to the reasonable intent of the parties, in most cases strictly construe them against the party claiming contractual indemnification, and subject them to public policy and equitable principles considerations. The resulting uncertainty with respect to the enforceability of these contractual provisions in any given set of circumstances is sufficiently great that California attorneys have generally avoided rendering unqualified enforceability opinions to that effect.

Indemnity Provisions Generally: The California Supreme Court has characterized indemnity as “the obligation resting on one party to make good a loss or damage another party has incurred.” *Rossmoor Sanitation, Inc. v. Pylon, Inc.*, 13 Cal. 3d 622 (1975). Prior to *Rossmoor*, judicial interpretation of express indemnity agreements under California law generally followed the rule in *MacDonald & Kruse, Inc. v. San Jose Steel Co.*, 29 Cal. App. 3d 413 (1972) which focused on the indemnitee’s “active” or “passive” negligence when determining the enforceability of different types of indemnity agreements. The courts typically interpreted “general” indemnity provisions as granting indemnitees protection only from damages caused by their passive as opposed to active negligence. Since active negligence falls outside the scope of general indemnity and hold-harmless agreements and involves affirmative acts of malfeasance, courts would often refuse indemnification or strictly construe those agreements against the indemnitee. Thus, under this general rule, a party would not be indemnified for its own active negligence under a “general” indemnity agreement. In *Rossmoor* and subsequent cases, however, while acknowledging this general rule, the courts caution against its mechanical application, noting that the active-passive dichotomy should not be wholly dispositive of the case. In *Rossmoor*, the court held that “[w]hether an indemnity agreement covers a given case turns primarily on contractual interpretation, and it is the intent of the parties as expressed in the agreement that should control. When the parties knowingly bargain for the protection at issue, the protections should be afforded. This requires an inquiry into the circumstances of the damage or injury and the language of the contract; of necessity, each case will turn on its own facts.” 13 Cal. 3d at 633. The *Rossmoor* court thus concluded that a contract may expressly provide for indemnification against an indemnitee’s own negligence, but that such an agreement “must be clear and explicit and is strictly construed against the indemnitee.” It noted that while a clause lacking such clarity and explicitness with regard to an indemnitee’s negligence (*i.e.*, a “general” indemnity clause) may be “construed to provide indemnity for a loss resulting in part from an indemnitee’s passive negligence, [it] will not be interpreted to provide indemnity if an indemnitee has been actively negligent.” *Id.* at 627-28.

In *Morton Thiokol, Inc. v. Metal Building Alteration Co.*, 193 Cal. App. 3d 1025 (1987), the court reaffirmed and expanded upon the *Rossmoor* court's interpretive framework, and held that indemnity agreements are valid despite the indemnitee's active negligence and despite the agreement's failure expressly to address this negligence (*i.e.*, in the context of "general" indemnity provisions). The court held that " . . . indemnity should be afforded under any circumstances where to do so furthers the manifest intent of the parties to the contract and where the loss sustained would not have occurred without the indemnitor's negligence." *Id.* at 1029. This doctrinal approach has been substantially reaffirmed in *Hernandez v. Badger Construction Equipment Co.*, 28 Cal. App. 4th 1791 (1994), *Roos v. Kimmel*, 55 Cal. App. 4th 573 (1997) (noting that the general rule disallowing actively negligent party's recovery under a general indemnity provision is only a method for ascertaining the parties' intent), and *Heppler v. J.M. Peters Co.*, 73 Cal. App. 4th 1265 (1999) (holding that the viability of the indemnity provision is dependent on contractual interpretation, specifically the intent of the parties as expressed in the contractual agreement, that each case will depend on its own facts necessitating individual inquiry into the circumstances of the damage and the language of the contract, and that "parties to an indemnity contract have great freedom of action in allocating risk, subject to certain limitations of public policy.").

Limitations to Indemnity Provisions: As an adjunct to traditionally strict judicial interpretation of contractual provisions indemnifying a party for damages arising out of its own misconduct and active negligence, courts have imposed additional limitations based upon public policy and equitable principles:

Construction Contracts: Responding to language in *Goldman v. Ecco-Phoenix Elec. Corp.*, 62 Cal. 2d 40, 44 (1964), the legislature in 1967 adopted Cal. Civ. Code Section 2782, which states that indemnity clauses in construction contracts may not provide indemnification for injury or loss due solely to the indemnitee's negligence or willful misconduct, and notes that such provisions are against public policy and are unenforceable and void. This section does not prohibit indemnification when the loss or injury is due only in part to the indemnitee's negligence or willful conduct.

Strict Liability: One line of cases has held on public policy grounds that strict products liability should be deemed a form of "active negligence" for purposes of interpreting indemnity agreements in certain circumstances. Illustrative is *Widson v. International Harvester Co.*, 153 Cal. App. 3d 45 (1984) (language imposing liability on product user must do so expressly; to hold otherwise would "thwart basic public policy behind strict liability to permit indemnification of a strictly liable defendant under a general liability clause."). That line of cases was distinguished in *Maryland Casualty Co. v. Bailey & Sons, Inc.*, 35 Cal. App. 4th 856 (1995), which noted that those cases equated strict liability with active negligence in order specifically to avoid the anomaly of permitting a party placing a defective product into commerce to abrogate by contractual indemnification its liability to the consumer. *Id.* at 871. The court found the public policy considerations underlying those cases to be inapplicable in a situation involving a contractor seeking indemnification from a subcontractor "who played an intricate part in the creation of the product," rather than in the use of the product. The court determined this finding to be in furtherance of another public policy consideration; namely, "the sharing of fault among those whose conduct caused the construction defect." *Id.* at 872.

Punitive Damages: In *Ford Motor Co. v. Home Insurance Co.*, 116 Cal. App. 3d 374 (1981), an insured sought indemnity for punitive damages against insurers as a result of defects in automobiles manufactured by the insured. The insured had argued that California Insurance Code Sections 250 and 533 allowed all liabilities, including those for punitive damages, to be insurable except losses caused by intentional acts, taking the position that strict product liability did not flow from an intentional act. The court, in holding that punitive damages are uninsurable as a matter of policy, reasoned that “the purpose of punitive damages is to punish and deter sufficiently culpable conduct . . . [and that] to accomplish this purpose, the award must be assessed against the party actually responsible for the wrong. *Id.* at 380.

Exculpatory Provisions: California decisional law has distinguished express indemnity agreements wherein an indemnitor agrees to save the indemnitee from the legal consequences of the conduct of one of the parties or of some third person, from contractual exemptions from liability or exculpatory provisions which have as their object obtaining exemption or waiver of liability from an injured party. With regard to the latter, Cal. Civ. Code Section 1668 provides as follows:

“CERTAIN CONTRACTS UNLAWFUL. All contracts which have for their object, directly or indirectly, to exempt anyone from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law.”

Exculpatory provisions are subject to strict judicial scrutiny and will be held invalid under Section 1668 if they “affect” or “involve” the “public interest.” See *Tunkl v. Regents of University of Cal.*, 60 Cal. 2d 92 (1963) (release from liability for future negligence imposed as a condition for admission to hospital found invalid on ground that it affected the public interest); *McCarn v. Pacific Bell Directory*, 3 Cal. App. 4th 173 (1992) (limitation of publisher’s liability to cost of advertisement does not violate public policy against releases for negligence in contracts involving the public interest).

To the extent that the provisions in question purport to exculpate a party from its own misconduct--*i.e.*, amount to a waiver of damages arising from misconduct, the proposed exception set forth in endnote 6, *supra*, adequately addresses them. Where the agreement being opined upon includes a general indemnity (*i.e.*, one that does not specifically address the indemnitee’s negligence), purports to indemnify a party with respect to its own violations of law or with respect to punitive damages, or involves a transaction that is subject to statutory limitations with respect to the level of conduct that may be indemnified against and includes an indemnity provision that is not tailored to those limitations, the opinion giver may choose to include an appropriate exception. The following sample language addresses indemnity provisions in these circumstances:

We advise you that indemnities may be limited on statutory or public policy grounds.

The Subcommittee believes that, as a matter of customary usage, the reference to “statutory” grounds for limitation of an indemnity obligation should be understood to include regulatory grounds, as well.

24. SELF HELP REMEDY PROVISIONS. Although there is little recent case law specific to the issue, existing California decisions have generally upheld the validity and constitutionality of such self-help contractual self-help remedies as setoff, repossession and nonjudicial foreclosure; courts have considered such traditionally afforded rights of creditors to be private, rather than state, action, and thus not subject to constitutional requirements of due process under either federal or state constitutions. See, e.g., *Kruger v. Wells Fargo Bank*, 11 Cal. 3d 352 (1974) and *Granberry v. Islay Investments*, 9 Cal. 4th 738 (1995) (right of setoff); *Adams v. Southern California First Nat'l Bank*, 492 F. 2d 324 (9th Cir. 1973) and *Kipp v. Cozens*, 40 Cal. App. 3d 709 (1974) (right of repossession); *Garfinkle v. Superior Court*, 21 Cal. 3d 268 (1978), *Strutt v. Ontario Sav. & Loan Ass'n.*, 28 Cal. App. 3d 866 (1972), *U.S. Hertz, Inc. v. Niobrara Farms*, 41 Cal. App. 3d 68 (1974), *Davidow v. Corporation of America*, 16 Cal. App. 2d 6 (1936); *Davidow v. Lachman Bros. Inv. Co.*, 76 F. 2d 186 (9th Cir. 1935) and *Lawson v. Smith*, 402 F. Supp. 851 (N.D. Cal. 1975) (right of nonjudicial foreclosure). Such rights are not absolute, however, and may be subject to judicial and statutory restrictions imposed to uphold a state public policy interest in protecting debtors' rights. While the possibility of such restrictions introduces a significant degree of uncertainty with respect to the enforceability of these contractual provisions, that uncertainty (subject to the following discussion with respect to breaches of the peace) is derived from judicially or statutorily imposed equitable principles. See *Kruger v. Wells Fargo Bank*, 11 Cal. 3d 352, 367-368 (1974) (protecting debtors' rights generally); *Flores v. Transamerica HomeFirst, Inc.*, 93 Cal. App. 4th 846 (2001) (unconscionability); *Henderson v. Security National Bank*, 72 Cal. App. 3d 764 (1977) (breach of peace); *County of Orange v. County of Orange*, 183 B.R. 609 (Bankr. C.D.Cal. 1995) (mutuality) and *Aplanalp v. Forte*, 225 Cal. App. 3d 609 (1990) (one-action rule). Accordingly, the equitable principles limitation adequately addresses the circumstances (except with respect to contractually authorized breaches of the peace) in which such provisions would not be enforced, and a separately stated exception is generally unnecessary.

Cal. UCC § 9609 permits a secured party, after default and without judicial intervention, to take possession of the collateral or to render equipment unusable and dispose of collateral on the debtor's premises, but only if it proceeds without breach of the peace, and § 9602 prohibits waivers of that obligation not to breach the peace. The right to immediate possession by a secured party upon default must be enforced through judicial action, rather than through self-help, if force or threats of force are necessary to secure possession of the collateral without judicial intervention. See *Henderson v. Security National Bank*, 72 Cal. App. 3d 764 (1977) (despite defendant's right to take possession of the automobile, its repossession through unlawful entry constituted a conversion). The Subcommittee considers this situation to be covered by the exception discussed in endnote 6, *supra*, relating to provisions that contain a waiver of statutory rights that, by statute, may not be waived, so that a separately stated exception specifically addressing a provision that purports to allow the secured party to breach the peace is unnecessary.

25. INDEMNIFICATION FOR SECURITIES LAW LIABILITIES. In general, indemnification provisions are enforceable under California law. See *Wagner v. Benson*, 101 Cal. App. 3d 27, 36 (1980); Cal. Civ. Code § 2772. California's state courts have not specifically addressed whether indemnification for securities law liabilities is enforceable, however, and federal law applies to indemnification provisions concerning securities liabilities

arising under federal securities laws. While courts disfavor contractual provisions that impede an investor's ability to enforce his or her rights under the securities laws, there is judicial reticence to encroach upon the freedom of parties to contract. See *Stratmore v. Combs* [II], 723 F. Supp. 458, 461 (N.D.Cal. 1989) rev'd on other grounds. Moreover, an indemnification provision may not shift securities liability to another party. See, e.g., *Laventhol, Krekstein, Horwath & Horwath v. Horwitch*, 637 F. 2d 672, 676 (9th Cir. 1980) cert. denied 452 U.S. 963 (1981), in which an underwriter and an accounting firm sought indemnity against the issuer in respect of misrepresentations in materials prepared for a public offering of the issuer's securities. The Laventhol court explained that allowing a party to escape liability for misrepresentations in the context of a securities transaction would thwart the goal of the federal securities laws: to encourage diligence and to deter negligence.¹¹

Section 14 of the Securities Act of 1933 (the "Act"), 15 U.S.C. §77n, voids any waiver of compliance with federal securities laws. Federal courts uniformly agree that a buyer of securities may not enforceably waive its right to enforce the securities laws, and provisions to that effect would be covered by the exception discussed in endnote 6, *supra*.¹² A more difficult question concerns whether an indemnification provision may provide that a buyer will indemnify a seller for damages resulting from misrepresentations by the buyer in a securities purchase agreement, even though the claims in respect of which indemnity is claimed by the seller involve breaches of the securities laws (e.g., if a buyer represents to the seller that the buyer is not relying on any oral representations of the seller in connection with its purchase of securities from the seller, but later brings an action against the seller asserting fraud based on alleged oral misrepresentations, whether the buyer's indemnity of the seller in respect of misrepresentations by the buyer will permit the seller to recover attorneys' fees from the buyer, even though the buyer's underlying claim is for violation by the seller of applicable securities law). With regard to these types of indemnification provisions, courts typically align with the reasoning of one of two seminal cases. The more restrictive view was pronounced in *Doody v. E.F. Hutton & Co., Inc.*, 587 F. Supp. 829 (D.Minn. 1984), in which the court refused to enforce an indemnification provision that would have forced the buyer to pay the seller's attorneys' fees in a securities fraud action. A more liberal approach was taken by the court in *Zissu v. Bear, Stearns, & Co.*, 627 F. Supp. 687 (S.D.N.Y. 1986), where the court enforced an indemnification provision despite the buyer's argument that enforcing indemnification provisions that require a plaintiff to pay for a defendant's attorneys' fees in a securities fraud action was against the public interest.

There is little Ninth Circuit case law addressing the enforceability of these types of indemnification provisions. At least one case, however, has held that an indemnification provision may be enforced where it pertains to the warranties and representations made by buyers in a securities purchase agreement and where the contract clearly specifies the obligation of the buyer to indemnify the seller for legal fees "in the event of an unsuccessful securities law

¹¹ *Laventhol* involved claims for indemnification arising under federal securities law and state law, but the court did not reach the indemnification issue attendant to the state law claims. It also distinguished between claims for *contribution*, which it did not see as inconsistent with the goal of the securities laws, and claims for *indemnity*, which it did.

¹² California Corps Code § 25701 parallels federal law in this respect.

suit by [the buyer].” *Stratmore v. Combs, supra*, 723 F. Supp. at 460 (discussing the importance of *Doody*, but adopting the reasoning of *Zissu*, while applying a very strict standard of clarity with respect to the wording of the indemnity provision in question).

The public policy against permitting one party to shift liability for breaches of the securities laws to another party, the conflicting judicial policies applicable to indemnities by buyers in securities purchase transactions, and the absence of decisive relevant case law make it difficult to render an opinion regarding the enforceability of such contractual provisions. Thus, it is customary practice to include an exception in a remedies opinion relating to the enforceability of those provisions. Sample language follows:

We express no opinion regarding the enforceability of [Section ____] of the [Agreement] [to the extent that it would require [the opinion giver’s client] to indemnify [the opinion recipient] in respect of [the opinion recipient’s] violations of securities laws].

26. VOTING AGREEMENTS. Some California opinion givers opine as to the enforceability of voting agreements and the rights contained therein, while others do not--in each case, largely because the statutory provisions affecting such agreements (Cal. Corp. Code §§ 705 and 706) have remained untested by the California courts. There appears to be no customary practice in this area.

27. PROVISIONS THAT GRANT RIGHTS OF SETOFF TO LOAN PARTICIPANTS OR TO AFFILIATES OF PARTIES TO THE AGREEMENT. An offset is the general right of one party to recover a debt owed by another through a deduction from monies owed by the first party to the second. (The doctrine of setoff is “an equitable doctrine requiring that the demands of mutually indebted parties be set off against each other and that only the balance be recovered.” 20 Am. Jur. 2d Counterclaim, Recoupment, Etc. § 6 (1995).) See also 80 C.J.S. Set-off & Counterclaim, § 3 (2000) (setoff “allows parties that owe mutual debts to each other to assert amounts owed, subtract one from the other, and pay only the balance”).) Basically, there are two types of offsets: setoffs and recoupments. A setoff is an equitable right of offset where the mutually offsetting debts arise out of separate transactions. In contrast, a recoupment is the right of offset when the claim and the debt arise out of the same transaction.

The right of setoff is available under the law of most, if not all, jurisdictions in the United States. In some jurisdictions, the right of setoff is a procedural right; in others, it is a common law right. Unless the parties otherwise contract to provide for setoff, however, common law or procedural setoff generally requires that there be mutuality between the parties and that the claims sought to be set off have matured. *See generally* Edison Electric Institute, *Survey of the Legal Landscape Applicable to Master Netting Agreements* (October 2002) (the “Edison Electronic Institute Netting Survey”)¹³ at p. 11. Because of the uncertainties those requirements

¹³ Available at the Edison Electronic Institutes website (<http://www.eei.org>), at http://www.eei.org/industry_issues/legal_and_business_practices/master_netting_agreement/legallandscape.htm.

can introduce into a situation, contracting parties will generally prefer to spell out their setoff rights in their agreement, rather than to rely solely upon principles of common law or procedure.

In California, the most common instances of setoffs are: 1) equitable setoffs used by courts to apply remedies to discharge or reduce a demand by one party to another; 2) setoffs used by banks in reducing a customer's accounts in satisfaction of a debt the customer owes the bank; 3) contractual setoffs; and 4) setoffs in the context of a bankruptcy. The first of these situations does not affect the enforceability of contractual setoff provisions, and the last of them is, of course, covered by the bankruptcy exception. Neither is separately addressed in this appendix.

Bank and Savings and Loan Setoffs. Under California law, banks and savings and loan associations have long had a right of equitable setoff against the funds of a general depositor. *See, e.g., Arnold v. San Ramon Valley Bank*, 184 Cal. 632, 635 (1921). Cal. Civ. Code § 3054 (described in *Arnold* as a codification of a “well-known rule of commercial law”) provides that bankers have a lien on customers' property in their possession.¹⁴ The California State Legislature has subjected the exercise of the banker's lien against deposit accounts (*i.e.*, by way of setoff) owned by natural persons to the restrictions of Cal. Finance Code §§ 864 and 6660. These restrictions prohibit a setoff that would result in a reduction in the balance of the customer's account to less than \$1000 and impose other restrictions intended to protect the affected customer. The restrictions do not apply, however, to an account in which the depository bank or savings association has a security interest under a written contract as collateral for a debt or where the customer has previously given written authority to “periodically debit” the account as an agreed method of payment.

Contractual Rights of Setoff. In California, parties may contract to provide a right of setoff. These contracts are often referred to as “netting contracts,” as the amount of the parties claim will generally “net” out. Generally, such provisions are enforceable in the bilateral context, even when setoff would not be available under applicable rules of common law or procedure (*e.g.*, because one or both of the obligations to be set off is not matured, or is not liquidated). *Parker v. Moore Grocery Co.*, 107 S.W.2d 1083 (Tex. 1937), *Allstate Ins. Co. v. Urban*, 23 F. Supp.2d 324 (E.D.N.Y. 1998); *see also Prudential Reinsurance Company v. Superior Court*, 3 Cal. 4th 1118, 1137 (1992) (indicating, in dicta, that setoff of debts pursuant to an express mutual agreement would be permissible); *Murphy v. FDIC*, 38 F.3d 1490, 1504 (9th Cir. 1994) (holding that a right to set-off may be based on contract or may arise independently of contract, as a matter of equity). Extant case law relating to multiparty setoff (sometimes referred to “triangular setoff”, since it involves at least three parties; one of which (“Party A”) may be trying to collect an obligation owed to it by a second party (“Party B”) by setting off amounts owed to Party B by an affiliate of Party A), provides support for the enforceability of such arrangements primarily by way of dicta. *See, e.g.*, Edison Electric Institute Netting Survey, *supra*, at 33 and nn. 66-70; *Prudential Reinsurance Company, supra*, 3 Cal. 4th at 1137. Most such cases (including *Prudential Reinsurance Company*) involve situations in which the court

¹⁴ Technically, funds credited to a deposit account are not “in the possession” of anyone; a deposit account is a general obligation of the depository bank to its customer. The statute clearly contemplates its application to deposit accounts, however: subsection (b) provides that “[t]he exercise of this lien with respect to deposit accounts shall be subject to the limitations and procedures set forth in Section 864 or 6660 of the Financial Code.”

disallows triangular setoff under common law, while observing that it would have allowed setoff had the parties specifically contracted for it. *Id.* The principle does not appear to be in doubt.

The Subcommittee found no cases indicating that contractual provisions granting rights of setoff in the commercial context would not be enforced, except to avoid inequity, a basis that falls within the scope of the equitable principles limitation. No additional exception need be taken.¹⁵

28. PROVISIONS THAT ARE UNCONSCIONABLE AS A MATTER OF LAW AT THE TIME OF CLOSING. As noted in the text of this appendix, at ¶ I.B.2.b. and the accompanying footnote 19, the Subcommittee concurs with the position taken by the Accord, the 1998 TriBar Report, and the 1987 Real Property Report to the effect that the equitable principles limitation should not be understood to encompass unconscionability that exists at the time of closing. As discussed in endnote 20, *supra*, with respect to agreements to arbitrate, a California court will not hold a provision of an agreement to be unconscionable as a matter of law unless it determines both¹⁶ that (i) unconscionable procedures—e.g., duress or coercion, or the use of an adhesion contract—were present in the execution and delivery of the agreement, and (ii) the provision is substantively unconscionable (e.g., in the context of agreements to arbitrate, if the agreement is unilateral, requiring only one party to submit to arbitration at the election of another party). In the absence of procedural unconscionability, no provision of an agreement should be held to have been unconscionable at the time it became effective.

Taking this into account, the Subcommittee endorses the approach taken by the 1998 TriBar Report for purposes of a remedies opinion:

- Absent knowledge to the contrary (*i.e.*, circumstances that would make it inappropriate to rely upon such an assumption), the opinion giver is entitled to assume the absence of conduct so egregious as to constitute procedural unconscionability.
- A remedies opinion should, as a matter of customary practice, be understood to include an assumption on the part of the opinion giver as to the absence of conduct so egregious as to constitute procedural unconscionability, regardless of whether the assumption is expressly stated.
- If, before rendering the opinion, the opinion giver believes that conduct—coercion, duress, or the like—amounts to procedural unconscionability, and if the opinion giver also concludes that one of the provisions is substantively unconscionable, the opinion giver should not render the opinion. If his/her client

¹⁵ This analysis, and the Subcommittee's conclusion, are limited to provisions, such as the Survey Provision, in which a debtor authorizes the affiliates or participants of a lender to set off against *that debtor* obligations they owe to it. Much more difficult issues (for example, suretyship issues) are raised by multiparty netting arrangements that permit recover by setoff against more than one obligator. *Id.*

¹⁶ The greater the procedural unconscionability, the less substantive unconscionability is necessary to render a provision unconscionable, and the greater the substantive unconscionability, the less procedural unconscionability is necessary to render a provision unconscionable.

consents, the opinion giver should disclose the concerns giving rise to his/her determination that no opinion can be rendered.

1998 TriBar Report, § 3.3.4, n. 77. On this basis, the opinion giver can generally assume that no procedural unconscionability exists and, thus, that no unconscionability exists at the time of the formation of the contract, even if a particular term of the contract may raise substantive unconscionability issues.

29. PAYMENTS FREE OF SETOFF OR COUNTERCLAIM. Provisions that require payments to be made free of any setoff, counterclaim or defense appear to be generally enforceable, outside of the context of consumer transactions and certain statutorily regulated seller-assisted marketing plans (for example, Cal. Civ. Code §§ 1812.200 et seq.) and the like, in which such waivers are prohibited by statute. See, e.g., Cal. Civ. Code §§ 1812.211 and 1812.216(a). Cal. UCC Sections 10407 (Uniform Section 2A-407) and 9403, on the other hand, expressly authorize such provisions in the context of commercial leases and secured transactions. The Subcommittee found no authority calling such provisions into question in the commercial context.

30. WAIVER OF STATUTE OF LIMITATIONS. Cal. Code Civ. Proc. § 360.5 provides, with respect to statutes of limitation contained in that Code, that no waiver executed prior to the expiration of the time limited for commencement of the action shall be effective for a period exceeding four years from the date of expiration of the time limited for commencement of the action; and no waiver executed after the expiration of such time shall be effective for a period exceeding four years from the date thereof, but any such waiver may be renewed for a further period not exceeding four years from the expiration of the immediately preceding waiver. Such waivers may be made successively. See *California First Bank v Braden*, 216 Cal App. 3d 672 (1989).

In a trust deed, a provision that the debtor waives the right to plead any and all statutes of limitation as a defense to any demand secured by the deed is void. See Cal. Code Civ. Proc. §§ 337(1), 580(a); *California Bank v Stimson*, 89 Cal. App. 2d 552 (1949).

Also, Cal. UCC § 2725(1) provides that an action for breach of any contract for sale must be commenced within four years after the cause of action has accrued and that while, by the original agreement, the parties may reduce the period of limitation to not less than one year, the parties may not extend the period beyond four years. Thus, in a contract subject to Division 2 of the California Uniform Commercial Code, a waiver extending the limitations period is prohibited. Division 3 of the California Uniform Commercial Code provides separate statutes of limitations applicable to claims with respect to negotiable instruments.

Given that these limitations on waiver are imposed by statutes that do not codify equitable principles, the limitations would not be included within the equitable principles limitation, and the opinion giver should include an appropriate exception when a provision of the contract purports to waive the statute of limitations in violation of these sections:

We advise you that the waiver of the applicable statute of limitations set forth in Section __ of [the Agreement] will be subject to the limitations of [the relevant statutory provision].

31. PROVISIONS THAT PERMIT THE EXERCISE OF REMEDIES WITHOUT CONSIDERATION OF THE MATERIALITY OF BREACH/CONSEQUENCE OF THE BREACH TO THE NON-BREACHING PARTY. As with the issues addressed in endnote 19, provisions permitting the exercise of remedies without regard to the materiality of the breach or of the consequences of the breach to the non-breaching party address issues that are inherently equitable in nature, and the principles discussed at endnote 19 apply as well to the provisions addressed by this endnote. (As noted in the text of this appendix, the drafters of the Accord and of the 1989 Report included concepts of materiality in the equitable principles limitation.) Relevant case law relates primarily to secured transactions (see, e.g., *Freeman v. Lind* 181 Cal. App. 3d 791(1986), in which the court held that where a borrower breached its covenant to maintain fire insurance, the lender could accelerate payment on the note only if it could show that lack of insurance impaired its security; *Wellenkamp v. Bank of America*, 21 Cal. 3d 943 (1978), in which the California Supreme Court prohibited an institutional lender from accelerating a loan pursuant to a "due-on-sale" clause because acceleration created an unreasonable restraint against alienation that was not justified by the risk to the lender's security), where courts uniformly required that such considerations be taken into account. It took legislation (Cal. Civ. Code § 2924.7 and the Federal Garn-St. Germain Depository Institutions Act of 1982, as set forth at 12 U.S.C. Section 1701j-3, respectively) to permit strict enforcement, in the context of secured real property transactions, of covenants to maintain insurance and not to transfer real property collateral. As it did with the concepts implicated by Survey Provision No. 19, and as did the drafters of the Accord when defining the equitable principles limitation, the Subcommittee considers the concepts implicated by this Survey Provision integral to the equitable principles limitation.

32. PROVISIONS THAT WOULD PERMIT THE OTHER PARTY TO REQUIRE PERFORMANCE WITHOUT REQUIRING CONSIDERATION OF THE IMPRACTICALITY OR IMPOSSIBILITY OF PERFORMANCE AT THE TIME OF ATTEMPTED ENFORCEMENT DUE TO UNFORESEEN CIRCUMSTANCES NOT WITHIN THE CONTEMPLATION OF THE PARTIES. Generally speaking, in California, five kinds of events may constitute impossibility or commercial impracticability: (1) the death or incapacity of the promisor; (2) the operation of law; (3) war or the act of a public enemy; (4) the destruction or nonexistence of the subject matter of an agreement; and (5) extraordinary difficulty or expense. See 1 Witkin, *Summary of Cal. Law: Contracts* §§ 782-86 (9th ed. 2001); Cal. Civ. Code §§ 1441, 1598, and 3531 (which collectively establish the default rule that impossibility excuses a contract party from performance). Cf. Cal. UCC § 2615 (delay in delivery of goods or non-delivery is not a breach "if performance has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order . . .").

Cal. Civ. Code § 1511(2), however, permits parties to agree that certain of the circumstances that otherwise would give rise to a defense of impossibility will not do so. Under

this provision, parties may overcome the default rule that a contract party is excused from performance by impossibility by making special provisions adjusting rights or allocating risks in the event of impossibility. Cal. Civ. Code § 1511(2) (permitting provisions to the effect that a party will remain obligated to perform despite prevention or delay by reason of “irresistible, superhuman cause” or the act of public enemies); *see also* Cal. Civ. Code § 3513 (permitting, generally, a contract party to waive legal rights); *Ahlgren v. Walsh*, 173 Cal. 27 (1916) (enforcing a contract term apportioning loss from fire or earthquake); *Autry v. Republic Productions, Inc.*, 30 Cal. 2d 144 (1947) (denying a motion picture actor who enlisted in the army the availability of a defense of impossibility as an excuse for the unperformed portion of his contract of employment because the parties had stipulated their rights in the event of enlistment); Cal. UCC § 2615 (which clearly contemplates agreements by sellers of goods, that the defense of impracticability will not apply in all circumstances: “Except so far as a seller may have assumed a greater obligation . . .”).

On the other hand, a court may be required to refuse to enforce a provision by which a party assumes an obligation to perform despite supervening impossibility by the application of statutory principles: Cal. Civ. Code § 1511(1) invalidates provisions imposing liability upon a person despite supervening impossibility where the event preventing or delaying performance is (1) an act of the other party or (2) the operation of law, “even though there may have been a stipulation that this shall not be an excuse.” *See also* Cal. Civ. Code § 1512 (“If the performance of an obligation be prevented by the creditor, the debtor is entitled to all the benefits which he would have obtained if it had been performed by both parties”).

Thus, while the Accord’s classification as a part of the equitable principles limitation of the principle requiring consideration of the impracticability or impossibility of performance at the time of attempted enforcement is accurate, in that a court always has the power to consider such issues, it is also the case that the parties to an agreement may, in many cases, agree that one or the other of them will remain bound notwithstanding the occurrence of certain circumstances that render its performance impracticable or impossible. The Subcommittee believes that the considerations—including those referred to in Cal. Civ. Code § 1511(1)—that would permit a court to refuse to enforce such an agreement are inherently equitable considerations, and that no exception need be separately stated with respect to this Survey Provision. The call is a close one, however, and the Subcommittee believes that opinion recipients should accept an exception that addresses the limitations of Cal. Civ. Code § 1511, should one be proffered by an opinion giver.

APPENDIX 11

REPORT OF THE GENERIC EXCEPTION SUBCOMMITTEE

I. INTRODUCTION

In addition to the bankruptcy, equitable principles and “separately stated” exceptions to the remedies opinion addressed in the Report of the Exceptions Subcommittee (Appendix 10), a general exception to the remedies opinion (the “generic exception”) is sometimes included as follows:

The opinion regarding enforceability set forth above is subject to the qualification that certain provisions of the contract covered by this opinion letter may be unenforceable, but such unenforceability will not [, subject to the other exceptions, qualifications and limitations in this opinion letter,] render the contract invalid as a whole or substantially interfere with realization of the principal benefits provided by the contract.¹

This report addresses issues raised by including the generic exception in an opinion, describes the current formulation of the generic exception, discusses certain alternative formulations that have been developed in recent years and summarizes the current state of customary practice regarding the use of the generic exception.

Including a general statement that “certain provisions of the contract covered by this opinion letter may be unenforceable” raises significant concerns on the part of the opinion recipient. On its face, the opinion giver is stating that some provisions of the contract may not be enforceable but not indicating which provisions may not be enforceable or why they may not be enforceable. Because of these concerns, this exception is qualified with the additional statement that: “such unenforceability will not [, subject to the other exceptions, qualifications and limitations in this opinion letter,] render the contract invalid as a whole or substantially interfere with realization of the principal benefits provided by the contract.” Even with this statement, many opinion recipients believe that the generic exception is too vague and significantly weakens the ability of the opinion recipient to rely on the remedies opinion.

Historically, the generic exception arose out of complex real estate secured lending transactions where there were substantial questions about enforceability, particularly in light of complex laws relating to nonjudicial foreclosure and the interaction of comprehensive, often one-sided, over-reaching provisions. Gradually, use of the generic exception spread to other complex asset-based transactions. Moreover, as noted in Appendix 8, use of the generic exception by California lawyers has become enmeshed, to some degree, within the controversy surrounding the “each and every” versus “essential provisions” debate. Some California

¹ This formulation of the generic exception is substantially identical to the “California Generic Exception” contained in the Bus. Law Section of the State Bar of Cal., *Report on the Third-Party Legal Opinion Report of the ABA Section of Business Law*, § III.G.1 (May 1992) [hereinafter *1992 Report*]. It should be noted that alternative formulations include the phrases “practical realization” of the benefits “intended to be” provided under the contract. These alternative formulations are disfavored by the Subcommittee because the phrases “practical realization” and “intended to be” are even more vague than the suggested language. Some opinion givers include the bracketed language to clarify that the assurances provided in the generic exception do not affect the other exceptions. See discussion *infra* Part III. However, no such inference to that effect should be drawn from the absence of the bracketed language.

lawyers, seeking to clarify to the opinion recipient that they are not addressing “each and every provision” in a contract, use the generic exception as a means to put the opinion recipient on notice that the opinion is limited in scope. As a result, use of the generic exception continues to be controversial.

II. CUSTOMARY USE OF THE GENERIC EXCEPTION

As noted above, the generic exception arose because lawyers opining on the enforceability of agreements in real estate secured lending transactions were uncomfortable relying on either the “laundry list” of separately stated exceptions to enforceability or “customary practice” (See Appendices 5 and 8). The hope was that including the generic exception would enable opinion givers in those transactions to avoid including a laundry list and would both clarify and simplify remedies opinions in these transactions. Over time, however, the general practice among real estate lawyers has been to use the generic exception to address general concerns about enforceability in these complex transactions while retaining the laundry list.

Opinion recipients criticize the generic exception because the phrases “realization of the principal benefits provided by the contract” and “substantially interfere” are vague and, in their view, render the remedies opinion too weak for them to rely on. It is very difficult, opinion recipients argue, for either party to know what the terms “realization of the principal benefits” or “substantially interfere” may mean at the time when the contract is being enforced. How, the argument goes, can an opinion recipient rely on the opinion or claim that an opinion was inaccurate if the opinion giver can argue that the remedy or provision that the opinion recipient could not enforce was not a “principal benefit” of the contract or that, the inability to enforce a certain remedy did not “substantially interfere” with the opinion recipient’s realization of the principal benefits of the contract? Accordingly, many opinion recipients resist inclusion of the generic exception outside of the traditional areas of real estate secured lending and other complex asset-based transactions.

Conversely, use of the generic exception may not actually provide the opinion giver with any great degree of comfort. The opinion giver relying on the generic exception may be forced to argue that, notwithstanding the fact that a specific remedy unavailable to the opinion recipient actually turned out to involve a “principal benefit” to the opinion recipient or that the failure of a specific remedy actually “substantially interfered” with one of the principal benefits to the opinion recipient, nevertheless, the generic exception should protect the opinion giver because it is unreasonable to believe that such remedy or such benefit was a principal benefit to the opinion recipient at the time the opinion was delivered. Because the generic exception language promises that the “unenforceability of a remedy will not . . . substantially interfere with realization of the principal benefits provided by the contract,” it is very likely that most finders of fact would place on the opinion giver the risk that a particular provision turned out to involve a “principal benefit,” or “substantially interfered” with enforcement of the contract. Thus, the opinion giver may face a heavy burden if it makes such an argument.

III. CONCLUSION REGARDING USE OF THE GENERIC EXCEPTION

The logic behind using the generic exception only in real estate secured loans and other complex asset-based transactions has never been clearly articulated. Although some opinion reports strictly limit use of the generic exception to its historical antecedents, that is, real estate secured loans and other complex asset-based transactions, the Subcommittee reiterates the view set forth in the 1992 Report that inclusion of the generic exception may be appropriate in other types of complex business transactions as well. However, it is the Subcommittee's view that the generic exception should not be included in remedies opinions as a means of limiting the opinion's coverage to "essential provisions".²

² See Appendix 8 attached *supra* for a discussion of the "essential provisions" approach to remedies opinions. In recent years, members of the real estate bar have attempted to change the format of the generic exception for real estate secured lending transactions to more precisely define its meaning. One approach suggested by the 1987 Real Property Report is as follows: "In giving this opinion, we advise you that a California Court may not strictly enforce certain provisions contained in the Loan Documents or allow acceleration of the maturity of the obligations evidenced by the Note if it concludes that such enforcement or acceleration would be unreasonable under the then existing circumstances. We do believe, however, that subject to the limitations expressed herein, enforcement or acceleration would be available if an Event of Default occurs as a result of a material breach of a material covenant contained in the Loan Documents." Joint Comm. of the Real Prop. Law Section of the State Bar of Cal. and the Real Prop. Section of the Los Angeles County Bar Ass'n., *Legal Opinions in California Real Estate Transactions*, 42 BUS. LAW 1139 (1987) [hereinafter *1987 Real Property Report*]. Although this language has the benefit of eliminating some of the subjectivity of the "realization of principal benefits" formulation, some have noted that determining which covenants and obligations are material is likely to be as difficult as determining what are the "principal benefits" a party is to receive under the Loan Documents.

A similar approach has been proposed by the New York real estate bar: "In addition, we advise you that certain provisions of the Loan Documents may be further limited or rendered unenforceable by applicable law, but in our opinion, such law does not render the Loan Documents invalid as a whole or preclude (i) the judicial enforcement of the obligation of the Borrower to repay the principal, together with interest thereon as provided in the Note, (ii) the acceleration of the obligation to repay such principal and interest upon a material default under the Loan Documents, (iii) the judicial foreclosure in accordance with applicable law of the lien created by the Mortgage upon failure to pay such principal and interest at maturity or upon acceleration pursuant to clause (ii) above and (iv) the judicial enforcement of the Assignment of Leases (and any similar provisions in the Mortgage) upon acceleration pursuant to clause (ii) for purposes of collecting rents accruing after the appointment of a receiver in an action to foreclose the Mortgage." Assoc. of the Bar of the City of N.Y. Committee on Real Prop. Law, *1998 Mortgage Loan Opinion Report*, 54 BUS. LAW. 119, § 4 (1998). Both the New York approach and the California formulation clarify the minimum remedies comprehended by the concept of "practical realization"; that is, the acceleration and judicial enforcement of the obligation to pay principal and interest and/or foreclosure of the lien on real property securing the loan (and, in the case of New York, the judicial enforcement of the Assignment of Rents). However, the events that trigger these remedies are defined by the concept of material breach of a material covenant, a definition that can be viewed as both ambiguous and circumstantial in nature.

Another alternative has been suggested by the a Joint Committee of the American Bar Association and the American College of Real Estate Lawyers (the "ACREL Approach"): "Certain provisions of the Transaction Documents may not be enforceable; nevertheless such unenforceability will not render the Transaction Documents invalid as a whole or preclude (i) the judicial enforcement of the obligation of the [Borrower] to pay the principal, together with interest thereon (to the extent not deemed a penalty), as provided in the Note, (ii) the acceleration of the obligation of the [Borrower] to repay such principal, together with such interest, based upon a material default by the [Borrower] in the payment of such principal or interest, and (iii) the foreclosure in accordance with applicable law of the lien on and security interest in the Collateral created by the Security Documents upon maturity or upon acceleration pursuant to clause (ii) above." Probate and Trust Law of the Am. Bar Assoc. and the Am. Coll. of Real Estate Lawyers, *Report on Adaptation of the Legal Opinion Accord of the Section of Business Law of the American Bar Association for Real Estate Secured Transactions of the Section of Real Property* (1993); 29 REAL PROP. PROB. & TR. J. 569, 595 (1994). While addressing, as do the above alternatives, the question of remedies, the ACREL

IV. REQUESTS FOR GENERAL ASSURANCES

Opinion recipients sometimes request that the opinion include “general assurance” language to the effect that “notwithstanding the exceptions stated above [which include the equitable principles limitation, the bankruptcy exception, the separately stated exceptions, and the generic exception if included], there exist in the documents or under applicable law legally adequate remedies for the realization of the principal benefits intended to be provided by the contract documents.” Such an assurance overrides the warnings about enforceability contained in the bankruptcy and equitable principles exceptions, any separately stated exceptions and the generic exception, if included in the opinion. It is inconsistent with the inclusion in the opinion of these exceptions and contrary to customary practice to request that the opinion giver opine that, no matter what, the opinion recipient will receive the principal benefits of the contract. Accordingly, the Subcommittee endorses the view, expressed in Section 4.0.a the American College of Real Estate Lawyers Attorneys’ Opinion Committee and the American Bar Association Section of Real Property, Probate and Trust Law Committee on Legal Opinions in Real Estate Transactions, *Real Estate Opinion Letter Guidelines* 38 REAL PROP. PROB. & TR. J. 251 (2003) and in Section 3.4.2 of the 1998 TriBar Report, that requests for such “general assurances” are inappropriate.

Approach also removes any doubt as to which covenants are material by specifying the payment of principal and interest. Whether the ACREL Approach, however unambiguous, will ultimately be acceptable to real estate industry opinion recipients remains uncertain.

The Subcommittee supports these efforts to describe more specifically the remedies that will be enforceable and believes that these approaches may well be preferable for real estate secured loan transactions. However, because translating these formulations from real estate secured loan transactions to personal property secured loans and corporate and other business transactions is difficult, the Subcommittee has elected not to modify substantially the recommended formulation of the generic exception in the 1992 Report.